

Edgar Filing: FENTURA FINANCIAL INC - Form 10-Q

FENTURA FINANCIAL INC
Form 10-Q
August 13, 2004

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, 2004

OR

☐ 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 Employer 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. ☒ Yes ☐ No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). ☐ Yes ☒ No

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: August 1, 2004

Class	Common Stock	Shares Outstanding
		1,885,662

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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)		JUN 30, 2004 (unaudited)	DEC 31, 2003
ASSETS			
Cash and due from banks	\$	23,566	\$ 16,509
Federal funds sold		5,300	3,650
Total cash & cash equivalents		28,866	20,159
Securities-available for sale		100,405	113,833
Securities-held to maturity, (fair value of \$13,727 at June 30, 2004 and \$12,519 at December 31, 2003)		13,661	12,169
Total securities		114,066	126,002
Loans held for sale		1,044	1,095
Loans:			
Commercial		239,983	146,450
Real estate loans - mortgage		30,488	18,335
Real estate loans - construction		38,901	32,913
Consumer loans		73,081	55,547
Total loans		382,453	253,245
Less: Allowance for loan losses		(4,917)	(3,414)
Net loans		377,536	249,831
Bank Owned Life Insurance		6,748	6,458
Bank premises and equipment		14,238	9,606
Federal Home Loan Bank stock		2,204	854
Accrued interest receivable		2,211	1,884
Goodwill and other intangible assets		9,480	0
Other assets		3,508	4,077
Total assets	\$	559,901	\$ 419,966
LIABILITIES			
Deposits:			
Non-interest bearing deposits	\$	74,196	\$ 58,708
Interest bearing deposits		402,555	289,817
Total deposits		476,751	348,525
Borrowings		4,027	3,449
Federal Home Loan Bank Advances		12,091	1,108
Repurchase Agreements		12,500	12,500
Subordinated debentures		12,000	12,000
Accrued taxes, interest and other liabilities		2,232	1,502
Total liabilities		519,601	379,084

SHAREHOLDERS' EQUITY

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Common stock - no par value		
1,883,647 shares issued (1,880,485 in Dec. 2003)	32,875	32,769
Retained earnings	9,010	8,238
Accumulated other comprehensive loss	(1,585)	(125)
	<hr/>	
Total shareholders' equity	40,300	40,882
	<hr/>	
Total Liabilities and Shareholders' Equity	\$ 559,901	\$ 419,966
	<hr/>	

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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 June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
INTEREST INCOME				
Interest and fees on loans	\$ 5,566	\$ 3,978	\$ 9,830	\$ 7,902
Interest and dividends on securities:				
Taxable	751	331	1,575	659
Tax-exempt	183	172	343	341
Interest on federal funds sold	12	35	21	61
Total interest income	6,512	4,516	11,769	8,963
INTEREST EXPENSE				
Deposits	1,792	1,293	3,214	2,589
Borrowings	290	28	562	50
Total interest expense	2,082	1,321	3,776	2,639
NET INTEREST INCOME	4,430	3,195	7,993	6,324
Provision for loan losses	363	668	636	964
Net interest income after Provision for loan losses	4,067	2,527	7,357	5,360
NONINTEREST INCOME				
Service charges on deposit accounts	973	934	1,852	1,742
Gain on sale of mortgages	145	434	242	788
Trust income	292	121	450	233
Gain (Loss) on sale of securities	0	19	0	31
Gain (Loss) on sale of fixed assets	0	201	(2)	201
Other income and fees	421	344	902	633
Total noninterest income	1,831	2,053	3,444	3,628
NONINTEREST EXPENSE				
Salaries and employee benefits	2,581	1,762	4,657	3,598
Occupancy	426	269	769	561
Furniture and equipment	574	365	987	723
Loan and collection	105	84	184	143
Advertising and promotional	150	98	258	187
Other operating expenses	955	774	1,733	1,456
Total noninterest expense	4,791	3,352	8,588	6,668
INCOME BEFORE TAXES	1,107	1,228	2,213	2,320
Applicable income taxes	286	318	570	589
NET INCOME	\$ 821	\$ 910	\$ 1,643	\$ 1,731
Per share:				
Net income - basic	\$ 0.44	\$ 0.48	\$ 0.87	\$ 0.92

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	Three Months Ended June 30,		Six Months Ended June 30,	
Net income - diluted	\$ 0.43	\$ 0.48	\$ 0.87	\$ 0.92
Cash Dividends declared	\$ 0.23	\$ 0.21	\$ 0.46	\$ 0.63

See notes to consolidated financial statements.

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

	Six Months Ended	Six Months Ended
(000's omitted)	June 30, 2004	June 30, 2003
COMMON STOCK		
Balance, beginning of period	\$ 32,769	\$ 30,236
Issuance of shares under		
Director stock purchase plan &		
Dividend reinvestment program	228	200
Repurchase stock	(122)	(657)
Balance, end of period	32,875	29,779
RETAINED EARNINGS		
Balance, beginning of period	8,238	9,395
Net income	1,643	1,731
Cash dividends declared	(871)	(1,187)
Balance, end of period	9,010	9,939
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)		
Balance, beginning of period	(125)	297
Change in unrealized gain (loss)		
on securities, net of tax	(1,460)	101
Balance, end of period	(1,585)	398
TOTAL SHAREHOLDERS' EQUITY	\$ 40,300	\$ 40,116

See notes to consolidated financial statements.

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

	Six Months Ended June 30,	
(000's omitted)	2004	2003
OPERATING ACTIVITIES:		
Net income	\$ 1,643	\$ 1,731
Adjustments to reconcile net income to cash		
Provided by Operating Activities:		
Depreciation and amortization	676	486
Provision for loan losses	636	964
Amortization (accretion) on securities	350	485
Loans originated for sale	(11,089)	(47,748)
Proceeds from the sale of loans	12,082	50,611
Gain on sale of securities	0	(31)
Gain on sales of fixed assets	2	0
Gain on sales of loans	(242)	(788)
Net increase in bank owned life insurance	(106)	(114)
Net (increase) decrease in interest receivable & other assets	1,056	(938)
Net increase (decrease) in interest payable & other liabilities	(964)	375
Total Adjustments	2,401	3,302
Net Cash Provided By (Used In) Operating Activities	4,044	5,033
Cash Flows From Investing Activities:		
Proceeds from maturities of securities - HTM	1,063	1,803
Proceeds from maturities of securities - AFS	2,216	2,540
Proceeds from calls of securities - HTM	3	0
Proceeds from calls of securities - AFS	36,196	16,962
Proceeds from sales of securities - AFS	0	10,998
Purchases of securities - HTM	(2,536)	(1,030)
Purchases of securities - AFS	(650)	(56,133)
Net increase in loans	(31,764)	(10,338)
Net cash from acquisition of WMFC	2,080	0
Capital expenditures	(571)	(209)
Net Cash Provided By (Used in) Investing Activities	6,037	(35,407)
Cash Flows From Financing Activities:		
Net increase (decrease) in deposits	18,398	43,362
Net increase (decrease) in borrowings	(19,007)	17
Net increase (decrease) in repurchase agreements	0	12,500
Net proceeds from stock issuance and purchase	106	(457)
Cash dividends	(871)	(1,187)
Net Cash Provided By (Used In) Financing Activities	(1,374)	54,235
NET INCREASE IN CASH AND CASH EQUIVALENTS	\$ 8,707	\$ 23,861
CASH AND CASH EQUIVALENTS - BEGINNING	\$ 20,159	\$ 30,562
CASH AND CASH EQUIVALENTS - ENDING	\$ 28,866	\$ 54,423

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	Six Months Ended June 30,	
CASH PAID FOR:		
INTEREST	\$ 3,754	\$ 2,650
INCOME TAXES	\$ 180	\$ 513
Noncash investing and financing activities:		
Securities acquired (including FHLB)	\$ 26,973	
Loans acquired	97,277	
Premises and equipment acquired	4,737	
Acquisition intangibles recorded	9,578	
Other assets acquired	900	
Deposits assumed	109,828	
Borrowings assumed	30,568	
Other liabilities assumed	1,149	
Value of common stock and converted stock options	8,220	
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 June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Net Income	\$ 821	\$ 910	\$ 1,643	\$ 1,731
Other comprehensive income (loss), net of tax:				
Unrealized holding gains (losses) arising during period	(1,833)	149	(1,460)	132
Less: reclassification adjustment for gains/losses included in net income	0	19	0	31
Other comprehensive income (loss)	(1,833)	130	(1,460)	101
Comprehensive income (loss)	(\$1,012)	\$ 1,040	\$ 183	\$ 1,832

Fentura Financial, Inc.
Notes to Consolidated Financial Statements (Unaudited)

Note 1. Basis of presentation

The consolidated financial statements at December 31, 2003 include Fentura Financial, Inc. (the Corporation) and its wholly owned subsidiaries, The State Bank in Fenton, Michigan and Davison State Bank in Davison, Michigan. The June 30, 2004 consolidated financial statements also include West Michigan Community Bank in Hudsonville, Michigan (collectively the Banks). As further discussed in Note 5, on March 15, 2004, the Corporation completed the acquisition of West Michigan Financial Corporation (WMFC) and its subsidiary, West Michigan Community Bank (WMCB). WMFC was merged with and into the Corporation on the date of the acquisition. WMCB remains a subsidiary of the Corporation. The acquisition was accounted for as a purchase and accordingly, these financial statements include the results of operations of WMFC and WMCB subsequent to March 15, 2004. 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 10Q 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 three and six months ended June 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004. 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, 2003.

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

All share and per share data has been adjusted for the 10% stock dividend paid on February 13, 2004.

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 credit card loans, 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.

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Stock Option Plans

The Nonemployee Director Stock Option Plan provides for the grant of options to nonemployee directors to purchase the Corporation's common stock on April 1 each year. 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 6,720 shares of stock may be granted under the Plan in any calendar year and options to acquire not more than 67,200 shares in the aggregate may be outstanding at any one time.

The Employee Stock Option Plan provides for the grant of 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 72,000 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. Options covering 14,575 shares were granted under this Plan on June 26, 2003.

The following table summarizes stock option activity:

	Number of Options	Weighted Average Price
Options outstanding at December 31, 2002	25,044	\$ 23.83
Options granted 2003	14,575	31.14
Options exercised 2003	(1,822)	17.58
Options forfeited 2003	(3,036)	23.96
Options outstanding at December 31, 2003	34,761	26.99
Options granted 2004	0	0.00
Options forfeited 2004	(110)	34.25
Options outstanding at June 30, 2004	34,651	\$ 26.99

The stock option plans are accounted for in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) as permitted under Financial Accounting Standards No. 123, *Accounting for Stock Based Compensation* (SFAS 123). In accordance with APB 25, no compensation expense is required nor has been recognized for the options issued under existing plans. Had the Corporation chosen not to elect APB 25, SFAS 123 would apply and compensation expense would have been recognized, and the Corporation's earnings would have been as follows (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Net Income				
As reported	\$ 821	\$ 910	\$ 1,643	\$ 1,731
Proforma	812	893	1,634	1,705
Basic net income per share				
As reported	0.44	0.48	0.87	0.92
Proforma	0.43	0.47	0.87	0.90
Diluted net income per share				
As reported	0.43	0.48	0.87	0.92
Proforma	0.43	0.47	0.87	0.90

Proforma net income includes compensation cost for the Corporation's stock option plan based on the fair values of the grants as of the dates of the awards consistent with the method prescribed by SFAS 123. The fair value of each option grant is estimated using the Black-Scholes option-pricing model. Assumptions used in the model for options granted during 2003 were as follows: an expected life of 6 years, a dividend yield of 3.6%, a risk free return of 2.78% and expected volatility of 24% resulting in a value of \$5.97 per option.

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Note 2. Earnings per common share

A reconciliation of the numerators and denominators used in the computation of basic earnings per common share and diluted earnings per common share is presented below. Earnings per common share are presented below for the three and six months ended June 30, 2004 and 2003:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Basic Earnings Per Common Share:				
Numerator				
Net Income	\$ 821,000	\$ 910,000	\$ 1,643,000	\$ 1,731,000
Denominator				
Weighted average common shares Outstanding	1,882,390	1,883,872	1,881,992	1,887,673
Basic earnings per common share	\$ 0.44	\$ 0.48	\$ 0.87	\$ 0.92
Diluted Earnings Per Common Share:				
Numerator				
Net Income	\$ 821,000	\$ 910,000	\$ 1,643,000	\$ 1,731,000
Denominator				
Weighted average common shares Outstanding for basic earnings per Common share	1,882,390	1,883,872	1,881,992	1,887,673
Add: Dilutive effects of assumed Exercises of stock options	6,153	6,838	5,091	6,870
Weighted average common shares And dilutive potential common Shares outstanding	1,888,543	1,890,710	1,887,083	1,894,543
Diluted earnings per common share	\$ 0.43	\$ 0.48	\$ 0.87	\$ 0.92

Stock options for 5,096 shares and 19,561 shares of common stock for the three and six months period ended June 30, 2004 and stock options for 5,737 shares and 6,841 shares of common stock for the three and six month periods ended June 30, 2003 were not considered in computing diluted earnings per common share because they were not dilutive.

Note 3. Commitments and contingencies

There are various contingent liabilities that are not reflected in the financial statements including claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material effect on the Corporation's consolidated financial condition or results of operations.

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Note 4. Securities

June 30, 2004 securities and year-end 2003 securities are as follows:

Available for Sale June 30, 2004	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
U.S. Government & federal agency	\$ 42,588	\$ 14	\$ (686)
State and Municipal	7,144	34	(29)
Mortgage-backed	49,628	60	(1,794)
Corporate	0	0	0
Equity securities	1,045	0	0
Total	\$ 100,405	\$ 108	\$ (2,509)

December 31, 2003			
U.S. Government & federal agency	\$ 62,882	\$ 243	\$ (38)
State and Municipal	6,791	83	(5)
Mortgage-backed	42,744	82	(571)
Corporate	1,021	16	0
Equity securities	395	0	0
Total	\$ 113,833	\$ 424	\$ (614)

Held to Maturity June 30, 2004	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Losses	Fair Value
State & municipal	\$ 13,634	\$ 209	\$ (145)	\$ 13,698
Mortgage-backed	27	2	0	29
Total	\$ 13,661	\$ 211	\$ (145)	\$ 13,727

December 31, 2003				
State & municipal	\$ 12,169	\$ 364	\$ (14)	\$ 12,519
Total	\$ 12,169	\$ 364	\$ (14)	\$ 12,519

Note 5. Acquisition

On October 15, 2003, the Corporation announced the signing of a definitive agreement to acquire West Michigan Financial Corporation (WMFC), a commercial bank headquartered in Hudsonville, Michigan. The purpose of the acquisition was to establish a presence in the West Michigan market resulting in a foundation to grow the Corporations asset base, primarily loans, in that market. Under the terms of the transaction, the Corporation acquired all of the outstanding stock of WMFC in exchange for cash. The total cost of the transaction was \$12.9 million. The Corporation closed the transaction on March 15, 2004.

The acquisition has been accounted for using the purchase method of accounting, and, accordingly, the purchase price has been allocated to the tangible and identified intangible assets purchased and the liabilities assumed based upon the estimated fair values at the date of acquisition. Identified intangible assets and purchase accounting fair value adjustments are being amortized under various methods over the expected lives of the corresponding assets and liabilities. Goodwill will not be amortized, but will be reviewed for impairment on a yearly basis. Identified intangible assets aggregate to \$1.7 million and include a core deposit intangible and customer relationship value related to WMFC s loan, deposit and wealth management customers. Goodwill aggregates to \$7.9 million.

In conjunction with the acquisition, the fair values of significant assets and liabilities assumed are as follows, stated in thousands of dollars:

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Cash and cash equivalents	\$	15,926
Securities		26,973
Loans		97,277
Acquisition intangibles		9,578
Deposits		109,828
Other borrowings		27,368

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The following table presents pro forma information stated in thousands of dollars for the six months ended June 30, 2004 and the year ended December 31, 2003 as if the acquisition of WMFC had occurred at the beginning of 2004 and 2003. The pro forma information includes adjustments for the amortization of intangibles arising from the transaction, the elimination of acquisition related expenses, and the related income tax effects. The pro forma financial information is not necessarily indicative of the results of operations as they would have been had the transactions been effected on the assumed dates.

	2004	2003
Interest income	\$ 13,160	\$ 25,333
Interest expense	4,204	8,185
Net interest income	8,956	17,148
Provision for loan losses	673	2,464
Net interest income after provision	8,283	14,684
Noninterest income	3,707	8,739
Noninterest expense	9,579	18,905
Income before federal income tax	2,411	4,518
Federal income tax expense	632	1,131
Net income	\$ 1,779	\$ 3,387
Basic earnings per share	\$ 0.95	\$ 1.80
Diluted earnings per share	0.94	1.79

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Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

Certain of the Corporation's accounting policies are important to the portrayal of the Corporation's financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Estimates associated with these policies are susceptible to material changes as a result of changes in facts and circumstances. Facts and circumstances, which could affect these judgments, include, but without limitation, changes in interest rates, in the performance of the economy or in the financial condition of borrowers. Management believes that its critical accounting policies include determining the allowance for loan losses and determining the fair value of securities and other financial instruments.

As indicated in the income statement, earnings for the three months ended June 30, 2004 were \$821,000 compared to \$910,000 for the same period in 2003. Year to date earnings for the first six months of 2004 were \$1,643,000 compared to \$1,731,000 for the same period in 2003. Earnings decreased in the second quarter of 2004 due to lower noninterest income and higher noninterest expense. Net interest income was higher due to significantly higher loan and security balances during the first six months of 2004 compared with the same period in 2003. Also the Corporation completed the acquisition of West Michigan Financial Corporation (WMFC) on March 15, 2004. As a privately held entity, WMFC experienced operating losses in 2002 and 2003. The company operated profitably during the first quarter of 2004 prior to the acquisition by Fentura Financial. Carrying costs associated with the Trust Preferred Securities issued in connection with the acquisition, coupled with legal, accounting and consulting acquisition expenses more than offset the income contribution of West Michigan Community Bank since the date of acquisition. The Corporation continues to focus on core banking activities and new opportunities in current and surrounding markets.

Net income per share basic and diluted was \$0.87 in the first six months of 2004 compared to \$0.92 net income per share basic and diluted for the same period in 2003. Net income per share basic was \$0.44 and diluted was \$0.43 in the second quarter of 2004 compared to \$0.48 for net income basic and diluted for the same period in 2003.

Net Interest Income

Net interest income and average balances and yields on major categories of interest-earning assets and interest-bearing liabilities for the six months ended June 30, 2004 and 2003 are summarized in Table 2. The effects of changes in average interest rates and average balances are detailed in Table 1 below.

Table 1

(000'S OMITTED)	SIX MONTHS ENDED JUNE 30, 2004 COMPARED TO 2003 INCREASE (DECREASE) DUE TO:		
	VOL	YIELD/RATE	TOTAL
TAXABLE SECURITIES	\$ 802	\$ 114	\$ 916
TAX-EXEMPT SECURITIES	(47)	50	3
FEDERAL FUNDS SOLD	(36)	(4)	(40)
TOTAL LOANS	3,305	(1,278)	2,027
LOANS HELD FOR SALE	(88)	(19)	(107)
TOTAL EARNING ASSETS	3,936	(1,137)	2,799
INTEREST BEARING DEMAND DEPOSITS	191	146	337
SAVINGS DEPOSITS	180	120	300
TIME CD'S \$100,000 AND OVER	16	(46)	(30)
OTHER TIME DEPOSITS	243	(225)	18
OTHER BORROWINGS	791	(279)	512
TOTAL INTEREST BEARING LIABILITIES	1,421	(284)	1,137
NET INTEREST INCOME	\$ 2,515	(\$ 853)	\$ 1,662

**SIX MONTHS ENDED
JUNE 30,
2004 COMPARED TO 2003
INCREASE (DECREASE)
DUE TO:**

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As indicated in Table 1, during the six months ended June 30, 2004, net interest income increased compared to the same period in 2003, principally because of the increase in securities interest income and the increase in loan interest income. Both loan and investment interest income increased due to higher balances during the first six months of 2004 compared to the same period in 2003. Interest expense increased compared to the first quarter of 2003 due to the increase in deposit balances and an increase in borrowings for the Corporation.

Net interest income (displayed with consideration of full tax equivalency), average balance sheet amounts, and the corresponding yields for the three months ended June 30, 2004 and 2003 are shown in Table 2. Actual net interest income for the six months ended June 30, 2004 was \$7,993,000, an increase of \$1,669,000, or 26.4%, over the same period in 2003. The primary factor contributing to the net interest income increase was the addition of West Michigan Community Bank, which increased net interest income \$1,309,000. Higher interest income also resulted in part from an increase in loan and investment income resulting from higher balances carried at the Corporation's other subsidiary banks during the first six months of 2004 compared to the same period in 2003. However, the increased volume was at a lower spread and as a result the net interest margin declined during the 2004 period.

Management reviews economic forecasts and strategy on a monthly basis. Accordingly, the Corporation will continue to strategically manage the balance sheet structure in an effort to create stability in net interest income. The Corporation expects to continue to seek out new loan opportunities while continuing to maintain sound credit quality.

As indicated in Table 2, for the six months ended June 30, 2004, the Corporation's net interest margin (with consideration of full tax equivalency) was 3.63% compared with 4.24% for the same period in 2003. This decline is attributable to the impact of an increase in volume at a lower spread, which helped increase net interest income but decreased the net interest margin. The Corporation's net interest margin was also negatively impacted by the Federal Reserve reducing interest rates at the end of the second quarter in 2003 and by the Corporation's investment of excess cash in lower yielding securities.

Average earning assets increased 45.9% or approximately \$143,196,000, of which \$72,760,000 was attributable to West Michigan Community Bank, comparing the first six months of 2004 to the same time period in 2003. Loans, the highest yielding component of earning assets, represented 71.3% of earning assets in 2004 compared to 73.5% in 2003. Average interest bearing liabilities increased 52.2% or \$134,152,000, of which \$62,766,000 was attributable to West Michigan Community Bank, comparing the first six months of 2004 to the same time period in 2003. Non-interest bearing deposits amounted to 16.1% of average earning assets in the first six months of 2004 compared with 15.4% in the same time period of 2003.

Management continually monitors the Corporation's balance sheet to insulate net interest income from significant swings caused by interest rate volatility. If market rates change in 2004, corresponding changes in funding costs will be considered to avoid any potential negative impact on net interest income. The Corporation's policies in this regard are further discussed in the section titled "Interest Rate Sensitivity Management."

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Table 2

AVERAGE BALANCES AND RATES (000's omitted)(Annualized)	SIX MONTHS ENDED JUNE 30,					
	2004			2003		
ASSETS	AVERAGE BALANCE	INCOME/ EXPENSE	YIELD/ RATE	AVERAGE BALANCE	INCOME/ EXPENSE	YIELD/ RATE
Securities:						
U.S. Treasury and Government Agencies	\$ 104,752	\$ 1,515	2.91%	\$ 44,865	\$ 587	2.64%
State and Political (1)	19,065	520	5.48%	21,034	517	4.95%
Other	1,729	60	6.98%	3,303	72	4.40%
Total Securities	125,546	2,095	3.36%	69,202	1,176	3.43%
Fed Funds Sold	4,316	21	0.98%	10,613	61	1.16%
Loans:						
Commercial	227,535	6,797	6.01%	156,565	5,284	6.81%
Tax Free (1)	4,732	148	6.29%	5,370	174	6.54%
Real Estate-Mortgage	26,312	863	6.60%	13,299	449	6.81%
Consumer	65,776	2,052	6.27%	53,937	1,926	7.20%
Total loans	324,355	9,860	6.11%	229,171	7,833	6.89%
Allowance for Loan Losses	(4,302)	(3,251)				
Net Loans	320,053	9,860	6.20%	225,920	7,833	6.99%
Loans Held for Sale	891	20	4.51%	2,926	127	8.75%
TOTAL EARNING ASSETS	\$ 455,108	\$ 11,996	5.30%	\$ 311,912	\$ 9,197	5.95%
Cash Due from Banks	21,682			17,609		
All Other Assets	35,153			20,021		
TOTAL ASSETS	\$ 507,641			\$ 346,291		
LIABILITIES & SHAREHOLDERS' EQUITY:						
Deposits:						
Interest bearing - DDA	\$ 97,619	523	1.08%	\$ 48,246	186	0.78%
Savings Deposits	130,761	890	1.37%	100,520	590	1.18%
Time CD's \$100,000 and Over	44,019	505	2.31%	31,710	535	3.40%
Other Time CD's	81,610	1,296	3.19%	74,244	1,278	3.47%
Total Deposits	354,009	3,214	1.83%	254,720	2,589	2.05%
Other Borrowings	37,073	562	3.05%	2,210	50	4.56%
INTEREST BEARING LIABILITIES	\$ 391,082	\$ 3,776	1.94%	\$ 256,930	\$ 2,639	2.07%
Non-Interest bearing - DDA	73,435			48,141		
All Other Liabilities	1,445			1,046		
Shareholders' Equity	41,679			40,174		
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	\$ 507,641			\$ 346,291		
Net Interest Rate Spread			3.36%			3.87%
Net Interest Income/Margin		\$ 8,220	3.63%		\$ 6,558	4.24%

(1) Presented on a fully taxable equivalent basis using a federal income tax rate of 34%.

Table 3

AVERAGE BALANCES AND RATES (000's omitted)(Annualized)	THREE MONTHS ENDED JUNE 30,					
	2004			2003		
ASSETS	AVERAGE BALANCE	INCOME/ EXPENSE	YIELD/ RATE	AVERAGE BALANCE	INCOME/ EXPENSE	YIELD/ RATE
Securities:						
U.S. Treasury and Government Agencies	\$ 100,644	\$ 719	2.87%	\$ 44,912	\$ 300	2.68%
State and Political (1)	21,428	277	5.23%	20,998	261	4.98%
Other	1,635	32	7.87%	2,758	31	4.51%
Total Securities	123,707	1,028	3.34%	68,668	592	3.46%
Fed Funds Sold	5,151	12	0.94%	12,211	35	1.15%
Loans:						
Commercial	262,943	3,850	5.89%	158,847	2,675	6.75%
Tax Free (1)	4,641	74	6.41%	5,241	86	6.61%
Real Estate-Mortgage	32,042	531	6.67%	14,036	233	6.66%
Consumer	73,134	1,128	6.20%	53,532	945	7.08%
Total loans	372,760	5,583	6.02%	231,656	3,939	6.82%
Allowance for Loan Losses	(4,900)	(3,256)				
Net Loans	367,860	5,583	6.10%	228,400	3,939	6.92%
Loans Held for Sale	628	8	5.12%	3,069	68	8.89%
TOTAL EARNING ASSETS	\$ 502,246	\$ 6,631	5.31%	\$ 315,604	\$ 4,634	5.89%
Cash Due from Banks	22,215			17,452		
All Other Assets	34,512			19,886		
TOTAL ASSETS	\$ 554,073			\$ 349,686		
LIABILITIES & SHAREHOLDERS' EQUITY:						
Deposits:						
Interest bearing - DDA	\$ 108,482	316	1.17%	\$ 46,871	91	0.78%
Savings Deposits	149,351	451	1.21%	103,407	308	1.19%
Time CD's \$100,000 and Over						