

# DELMAR BANCORP

ANNUAL REPORT  

---

DECEMBER 31, 2014

**DELMAR BANCORP  
AND SUBSIDIARIES  
SELECTED FINANCIAL DATA**

At year end:	2014	2013	2012
Total assets	\$ 447,970,005	\$ 415,913,206	\$ 430,204,861
Loans receivable, net	378,066,900	338,028,301	319,176,371
Investment securities	33,746,796	37,648,048	44,810,659
Federal funds sold	1,384,699	1,149,856	18,468,347
Demand and NOW deposits	138,571,471	121,197,347	115,042,416
Savings and time deposits	242,159,995	233,978,061	255,596,601
Stockholders' equity	45,113,435	40,864,389	38,704,893
Common equity per share	4.90	4.41	5.88
For the year:			
Total income	23,258,064	20,836,383	21,722,793
Total expenses	19,748,981	26,397,655	20,826,546
Net income (loss)	3,509,083	(5,561,272)	896,247
Basic earnings (loss) per share	0.325	(1.145)	0.040
Basic earnings (loss) per share, excluding intangibles	0.329	(1.138)	0.048
Key ratios:			
Yield on earning assets	4.60%	4.52%	4.67%
Net interest income	16,347,383	15,223,589	14,968,603
Return on average assets	0.81%	-1.32%	0.21%
Return on average equity	8.16%	-13.98%	2.34%
Average equity to average assets	9.95%	9.40%	8.78%
Tier I risk-based capital	(Bank) 11.73%	10.37%	11.22%
Total risk-based capital	(Bank) 12.96%	11.64%	12.47%
Leverage capital ratio	(Bank) 9.60%	8.33%	8.69%
(See Note 15)			
Number of branch offices	10	10	10
Number of administrative offices	2	2	2
Number of employees	110	111	105

# DELMAR BANCORP

March 9, 2015

Dear Shareholders:

After writing these letters since the 1990 annual report, I can unequivocally say I am the most pleased to write this one. The reason I say that is the bottom line of the Company in 2014. We finally have returned to an acceptable level of profitability for the first year since 2008. I am also pleased to report that the problem asset resolution plan we put into place late in 2013 played out the way we had expected. Simply put, that plan was to use additional capital available to us in late 2013 to accelerate the write-down and write-off of legacy loans and other problem assets with the expectation that 2014 would be a rebound year, which is what happened.

We also had fairly ambitious growth goals for 2014, which, for the most part, we achieved or exceeded. Our lending teams were very busy resulting in loan growth of \$40.0 million, net of the allowance. This loan growth was the fuel of our improved net interest income, which increased by more than \$1.1 million to \$16.3 million. We also took advantage of the valuation increase of four TRUPs bonds to sell them at a significant gain early in the year. We used a large portion of the gain to further reduce our problem loan exposure.

Our net income in 2014 was \$3.5 million or \$.325 per share, which is a significant turnaround from 2013. Also highlighted in this financial statement, our capital levels remain strong and our credit quality improved in 2014. Despite a regional economy which has not yet recovered (aside from the resort areas), the Bank has maintained solid capital and has worked through many of our credit issues.

During the year we added two directors who provide additional knowledge and experience to the Boards of both the Holding Company and the Bank. Heidi Gilmore is an attorney from the Rehoboth area. Heidi's legal expertise is real estate law and working with non-profits and along with her legal background she brings to us an extensive knowledge of businesses in Sussex County. Ken Lehman is a private bank investor who made a significant investment in Delmar Bancorp in 2013. Ken has extensive experience dealing with capital structures and needs of financial institutions. We are fortunate to have both Heidi and Ken as part of our team.

As far as 2015 is concerned, our plan is to build on the momentum from last year. We project another year of solid loan and asset growth. Funding that growth will likely be a greater challenge than in the recent past. We expect to continue to chip away at our classified assets and to maintain capital levels well in excess of regulatory requirements. We also project another profitable year.

The Holding Company still has about \$4.5 million of preferred stock on the books as well as deferred dividends owed. Our intention this year is to catch up on the dividends in arrears and then replace the preferred shares with debt. Once those steps are accomplished, we will be able to consider reestablishing a common stock dividend.

This has been a long journey since the depths of the recession of 2008. However, we are not naïve and we know there will be unexpected challenges this year still. We look forward to a prosperous and successful 2015.

Very truly yours,

A handwritten signature in black ink, appearing to read "Edward M. Thomas". The signature is fluid and cursive, with a large, stylized "E" and "T".

Edward M. Thomas  
President and Chief Executive Officer

## Executive Overview

Delmar Bancorp is a bank holding company whose primary assets include The Bank of Delmarva. The financial statement of Delmar Bancorp consolidates the financial statements of Delmar Bancorp, The Bank of Delmarva, Eastern Shore Insurance Holdings, Inc., Delmarva Real Estate Holdings LLC, DHB Development LLC of which the Bank holds a 40.55% interest, West Nithsdale Enterprises LLC of which the Bank holds a 10.00% interest and Salisbury Housing LLC of which the Bank holds a 50.00% interest. During 2013 Eastern Shore Insurance Holdings, Inc. was dissolved and liquidated. The discussion and analysis which follow pertain to the operation of all the entities during 2014, but with the primary focus on the Bank.

Consolidated assets of Delmar Bancorp increased 7.7% to end the year at \$448.0 million, which was an annual increase of \$32.1 million.

The Bank's investment portfolio consists of Federal Agency, municipal, mortgage-backed and equity securities. The investment portfolio was \$33.7 million at the end of 2014 or a decrease of \$3.9 million from \$37.6 million in 2013.

The Bank's loan portfolio, net of the Allowance for Credit Losses, was \$378.1 million at the end of 2014 or an increase of \$40.0 million from \$338.0 million in 2013.

The Bank's Allowance for Credit Losses was \$8.2 million at year end and represents 2.1% of ending loan balances. A total of \$1.4 million was expensed from operations and added to the Allowance in 2014. Charge-offs of \$2.2 million and recoveries of \$686,000 in addition to the \$1.4 million which was expensed from operations accounted for the change in the Allowance for 2014. Management believes that the Allowance for Credit Losses is considered adequate based upon the nature of the Bank's loan portfolio, historical loan losses and the credit quality of the current loan portfolio as of December 31, 2014, however there can be no guarantees that additional charge-offs or additional provisions for nonperforming loans will not be required or that currently performing loans will continue to perform at their current levels.

The primary source of funding for the Bank's loan and investment activities comes from deposit accounts owned by individuals, corporations, partnerships and other entities and from Federal Home Loan Bank borrowings. Total deposits increased by \$25.6 million to \$380.7 million. Non-interest bearing demand accounts were 31.5% of total deposits and were \$119.9 million at the end of 2014, an increase of \$15.2 million or 14.5% compared to 2013. Interest bearing deposits were \$260.9 million at the end of 2014. NOW accounts, savings and money market account balances decreased by 0.3% while certificates of deposit balances increased by 7.2% compared to 2013.

Federal Home Loan Bank borrowings provide additional funding for short term and long term needs. The Bank ended 2014 with \$15 million in long term borrowings and \$6.5 million in short term borrowings compared to \$15 million in long term borrowings and \$4.0 million in short term borrowings at December 31, 2013.

Total capital at the holding company increased by approximately \$4.2 million or 10.4%. Adjustments to capital in 2014 include, net income of approximately \$3.5 million, less the after tax adjustment of the difference between the book and market value of available for sale securities in the bond portfolio. Tangible capital at year end was \$45.1 million in comparison to \$40.8 million at the end of 2013. The holding company and the Bank are subject to various regulatory capital requirements administered by Federal banking agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the holding company and Bank must meet specific capital adequacy guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. At December 31, 2014 the

holding company and Bank met all capital adequacy requirements to which they are subject and are considered to be "Well Capitalized". Management's goal is to maintain capital levels in excess of minimum regulatory capital guidelines that are sufficient to support potential growth and absorb potential losses. During 2014 no dividends were paid on preferred or common stock outstanding. The payment of dividends by the holding company depends largely on the Bank's ability to declare and pay dividends to the holding company.

The Bank's primary source of income is interest income derived from the loan and bond portfolios. Total interest income in 2014 was \$18.5 million, an increase of approximately \$699,000 from 2013. Interest income from the loan portfolio was \$17.7 million at the end of 2014. Interest income from the bond portfolio was approximately \$808,000, which included approximately \$397,000 in income exempt from federal taxation.

The primary source of expense is interest expense paid to depositors and for other borrowed money. Interest paid to depositors totaled \$1.9 million, a decrease of approximately \$385,000 from 2013. Total interest expense in 2014 was \$2.2 million as compared to \$2.6 million in 2013.

Net interest income for 2014 totaled \$16.3 million. This is an increase of 7.4% over the prior year's \$15.2 million in net interest income. The net interest margin in 2014 was 4.06%, compared to 3.86% in 2013.

Other income includes service charges on deposit products, rental of safe deposit boxes, the brokerage of stock and bond products, and gains on the sale of assets and securities. Other income increased approximately \$1.7 million in 2014 due to a one time gain on the sale of investment securities of approximately \$1.7 million.

Operating expenses were \$14.2 million in 2014 compared to \$17.3 million in 2013, representing a decrease of \$3.1 million or 18.0%. Other-than-temporary impairment losses of \$3.6 million in 2013 account for the decrease in operating expenses. Other-than-temporary impairment losses were \$3.6 million in 2013 compared to zero in 2014. The operating expense to average asset ratio of the holding company, excluding impairment losses, was 3.3% in 2014 and 2013.

Net income was approximately \$3.5 million in 2014 compared to net loss of approximately \$5.6 million reported in 2013. This is an increase of approximately \$9.1 million. Total shares outstanding at year end 2014 and 2013 were 8,116,066. The basic earnings (loss) per share increased to \$.325 per share in 2014 from (\$1.145) per share in 2013.



## INDEPENDENT AUDITORS' REPORT

Board of Directors  
Delmar Bancorp  
Salisbury, Maryland

### **Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of Delmar Bancorp and subsidiaries, which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of operations, statements of comprehensive income (loss), changes in stockholders' equity, and cash flows for the three years in the period ended December 31, 2014, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate

in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Delmar Bancorp and its subsidiaries as of December 31, 2014 and 2013, and the results of their operations and their cash flows for the three years ended December 31, 2014, in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink, appearing to read "JHM Group LLC". The signature is fluid and cursive, with the letters "J", "H", and "M" being particularly prominent and stylized.

Salisbury, Maryland  
February 26, 2015



**DELMAR BANCORP**  
**CONSOLIDATED BALANCE SHEETS**  
**December 31, 2014 and 2013**

	2014	2013
<b>ASSETS</b>		
Cash and due from banks	\$ 13,223,201	\$ 11,105,238
Interest bearing deposits in other financial institutions	1,001,803	5,691,374
Federal funds sold	1,384,699	1,149,856
Securities available for sale, at fair value	33,746,796	37,648,048
Loans, less allowance for credit losses		
2014 <b>\$8,185,387</b> ; 2013 \$8,296,924	<b>378,066,900</b>	338,028,301
Accrued interest receivable on loans and investment securities	1,301,035	1,172,855
Premises and equipment, at cost, less accumulated depreciation	7,375,268	7,295,908
Federal Home Loan Bank stock, at cost	1,341,800	1,371,300
Maryland Financial Bank stock	30,000	30,000
Atlantic Central Bankers Bank stock, at cost	75,000	75,000
Other investments	1,000,000	1,000,000
Intangible assets, net of accumulated amortization	38,578	90,013
Deferred tax asset	4,064,957	6,312,175
Other real estate owned	3,722,569	3,164,152
Other assets	1,597,399	1,778,986
<b>Total assets</b>	<b>\$ 447,970,005</b>	<b>\$ 415,913,206</b>
<b>LIABILITIES</b>		
Deposits:		
Non interest bearing demand	\$ 119,856,293	\$ 104,667,478
NOW	18,715,178	16,529,869
Savings and money market	83,076,235	85,602,506
Time, \$100,000 or more	52,573,523	52,795,613
Other time	106,510,237	95,579,942
	<b>380,731,466</b>	<b>355,175,408</b>
Accrued interest payable on deposits	195,804	203,925
Short-term borrowings	6,500,000	4,000,000
Long-term borrowings	15,000,000	15,000,000
Other liabilities	429,300	669,484
<b>Total liabilities</b>	<b>402,856,570</b>	<b>375,048,817</b>
<b>COMMITMENTS, CONTINGENCIES &amp; SUBSEQUENT EVENT</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, par value \$.01, authorized 9,990,550 shares, issued and outstanding 2014 and 2013 <b>8,116,066</b>	<b>81,161</b>	81,161
Preferred stock, Series A and B (See Note 19)	4,450,000	4,450,000
Surplus	16,488,679	16,125,746
Retained earnings	23,848,738	20,429,655
Accumulated other comprehensive income (loss), net of deferred (tax) benefits 2014 <b>(\$159,598)</b> ; 2013 \$144,620	244,857	(222,173)
<b>Total stockholders' equity</b>	<b>45,113,435</b>	<b>40,864,389</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 447,970,005</b>	<b>\$ 415,913,206</b>

*The Notes to Consolidated Financial Statements are an integral part of these consolidated financial statements.*

**DELMAR BANCORP**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**Years Ended December 31, 2014, 2013, and 2012**

	2014	2013	2012
<b>INTEREST INCOME ON:</b>			
Loans, including fees	\$ 17,672,000	\$ 16,817,199	\$ 17,716,844
Investment securities:			
Taxable	411,099	511,797	559,564
Exempt from Federal income tax	396,916	437,288	501,848
Federal funds sold	7,415	22,670	47,546
Other interest income	58,046	58,043	42,411
	<b>18,545,476</b>	<b>17,846,997</b>	<b>18,868,213</b>
<b>INTEREST EXPENSE ON:</b>			
Deposits	1,879,532	2,264,462	3,146,262
Borrowings	318,561	358,946	753,348
	<b>2,198,093</b>	<b>2,623,408</b>	<b>3,899,610</b>
<b>NET INTEREST INCOME</b>	<b>16,347,383</b>	<b>15,223,589</b>	<b>14,968,603</b>
Provision for credit losses	1,400,000	9,794,000	4,277,000
<b>NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES</b>	<b>14,947,383</b>	<b>5,429,589</b>	<b>10,691,603</b>
<b>OTHER INCOME:</b>			
Service charges on deposit accounts	1,530,104	1,644,505	1,509,056
Gains on investment securities	1,667,779	27,700	46,538
Gains (losses) on disposal of other assets	46,620	(871)	52,764
Other income	1,468,085	1,318,052	1,246,222
	<b>4,712,588</b>	<b>2,989,386</b>	<b>2,854,580</b>
<b>OTHER EXPENSES:</b>			
Salaries and employee benefits	6,876,329	6,038,229	5,583,176
Premises and equipment	1,840,326	1,641,386	1,623,678
Amortization of intangibles	51,435	60,615	63,675
Losses on other real estate owned	628,081	492,961	275,504
Other expenses	4,814,099	5,535,087	4,776,091
Total other-than-temporary impairment losses:	-	3,554,942	4,582,266
Portion of other-than-temporary losses recognized in other comprehensive income (before taxes)	-	-	(4,451,766)
Net other than temporary impairments	-	3,554,942	130,500
	<b>14,210,270</b>	<b>17,323,220</b>	<b>12,452,624</b>
<b>INCOME (LOSS) BEFORE TAXES (BENEFIT) ON INCOME (LOSS)</b>	<b>5,449,701</b>	<b>(8,904,245)</b>	<b>1,093,559</b>
Federal and state income taxes (benefit)	1,940,618	(3,342,973)	197,312
<b>NET INCOME (LOSS)</b>	<b>\$ 3,509,083</b>	<b>\$ (5,561,272)</b>	<b>\$ 896,247</b>
Earnings (losses) per common share (See Note 14)			
Basic	\$ 0.325	\$ (1.145)	\$ 0.040
Diluted	0.315	(1.145)	0.040

*The Notes to Consolidated Financial Statements are an integral part of these consolidated financial statements.*

**DELMAR BANCORP**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
**Years Ended December 31, 2014, 2013, and 2012**

	2014	2013	2012
<b>NET INCOME (LOSS)</b>	<b>\$ 3,509,083</b>	<b>\$ (5,561,272)</b>	<b>\$ 896,247</b>
<b>OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:</b>			
Unrealized holding gains (losses) on securities available for sale arising during the period	2,439,092	(694,634)	(105,595)
Deferred (liabilities) income benefits	(962,222)	274,033	41,657
Other comprehensive income (loss), net of tax	1,476,870	(420,601)	(63,938)
Reclassification adjustment for gains included in net income	(1,667,779)	(27,700)	(46,538)
Deferred income tax liabilities	657,939	10,928	18,359
Other comprehensive loss, net of tax	(1,009,840)	(16,772)	(28,179)
Reclassification adjustment for impairment losses on investments included in net income	-	3,554,942	130,500
Deferred income tax benefits	-	(1,402,425)	(51,482)
Other comprehensive income, net of tax	-	2,152,517	79,018
<b>TOTAL OTHER COMPREHENSIVE INCOME (LOSS)</b>	<b>467,030</b>	<b>1,715,144</b>	<b>(13,099)</b>
<b>COMPREHENSIVE INCOME (LOSS)</b>	<b>\$ 3,976,113</b>	<b>\$ (3,846,128)</b>	<b>\$ 883,148</b>

*The Notes to Consolidated Financial Statements are an integral part of these consolidated financial statements.*

**DELMAR BANCORP**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
**Years Ended December 31, 2014, 2013, and 2012**

	Common Stock	Surplus	Preferred Stock (See Note 19)	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balances, December 31, 2011	\$ 48,661	\$ 4,956,679	\$ 9,450,000	\$ 25,274,680	\$ (1,924,218)	\$ 37,805,802
<b>COMPREHENSIVE INCOME</b>						
Net income	-	-	-	896,247	-	896,247
Other comprehensive loss, net of tax:						
Unrealized holding losses on securities available for sale arising during the period	-	-	-	-	(63,938)	
Reclassification adjustment for gains included in net income	-	-	-	-	(28,179)	
Reclassification adjustment for impairment loss included in net income	-	-	-	-	79,018	
						(13,099)
<b>TOTAL COMPREHENSIVE INCOME</b>						<b>883,148</b>
Accretion of TARP warrants	-	90,000	-	(90,000)	-	-
Stock-based compensation expense recognized in earnings	-	15,943	-	-	-	15,943
Balances, December 31, 2012	48,661	5,062,622	9,450,000	26,080,927	(1,937,317)	38,704,889
<b>COMPREHENSIVE INCOME (LOSS)</b>						
Net (loss)	-	-	-	(5,561,272)	-	(5,561,272)
Other comprehensive gain, net of tax:						
Unrealized holding losses on securities available for sale arising during the period	-	-	-	-	(420,601)	
Reclassification adjustment for gains included in net income	-	-	-	-	(16,772)	
Reclassification adjustment for impairment loss included in net income	-	-	-	-	2,152,517	
						1,715,144
<b>TOTAL COMPREHENSIVE INCOME</b>						<b>(3,846,128)</b>
Stock issuance	32,500	5,967,500	-	-	-	6,000,000
Preferred stock converted to common stock	-	5,000,000	(5,000,000)	-	-	-
Accretion of TARP warrants	-	90,000	-	(90,000)	-	-
Stock-based compensation expense recognized in earnings	-	5,624	-	-	-	5,624
Balances, December 31, 2013	81,161	16,125,746	4,450,000	20,429,655	(222,173)	40,864,389
<b>COMPREHENSIVE INCOME</b>						
Net income	-	-	-	3,509,083	-	3,509,083
Other comprehensive gain, net of tax:						
Unrealized holding gains on securities available for sale arising during the period	-	-	-	-	1,476,870	
Reclassification adjustment for gains included in net income	-	-	-	-	(1,009,840)	
						467,030
<b>TOTAL COMPREHENSIVE INCOME</b>						<b>3,976,113</b>
Accretion of preferred warrants	-	90,000	-	(90,000)	-	-
Stock-based compensation expense recognized in earnings	-	272,933	-	-	-	272,933
Balances, December 31, 2014	\$ 81,161	\$ 16,488,679	\$ 4,450,000	\$ 23,848,738	\$ 244,857	\$ 45,113,435

*The Notes to Consolidated Financial Statements are an integral part of these consolidated financial statements.*

**DELMAR BANCORP**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**Years Ended December 31, 2014, 2013, and 2012**

	2014	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income (loss)	\$ 3,509,083	\$ (5,561,272)	\$ 896,247
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Provision for credit losses and unfunded commitments	1,400,000	9,794,000	4,277,000
Depreciation	560,717	542,118	579,903
Amortization and accretion	176,265	255,374	291,763
Impairment loss on investment securities	-	3,554,942	130,500
Gain on investment securities	(1,667,779)	(27,700)	(46,538)
Net losses (gains) on sales of assets	-	871	(52,764)
Net losses on other real estate owned	628,081	492,961	275,504
Deferred income tax expenses (benefits)	1,935,095	(3,432,000)	262,426
Stock-based compensation expense	272,933	5,624	15,943
Changes in assets and liabilities:			
(Increase) decrease in accrued interest receivable	(128,180)	23,526	252,356
Decrease (increase) in other assets	189,492	752,187	(115,125)
Decrease in accrued interest payable	(8,121)	(90,121)	(96,244)
(Decrease) increase in other liabilities	(240,184)	102,579	(74,509)
<b>Net cash provided by operating activities</b>	<b>6,627,402</b>	<b>6,413,089</b>	<b>6,596,462</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchases of securities available for sale	(7,055,304)	(3,409,934)	(24,722,826)
Purchases of other investments	-	-	(1,000,000)
Proceeds from maturities and calls of securities available for sale	4,182,038	8,661,419	12,066,504
Proceeds from sales of securities available for sale	9,088,715	1,021,500	4,129,682
Proceeds from sale of assets	-	-	539,000
(Increase) decrease in loans, net	(44,606,491)	(30,930,152)	12,993,063
Purchases of premises and equipment	(640,077)	(259,344)	(1,222,512)
Proceeds from the sale of foreclosed assets	1,981,394	491,268	1,312,427
Sale of Federal Home Loan Bank stock	29,500	190,100	124,300
<b>Net cash (used in) provided by investing activities</b>	<b>(37,020,225)</b>	<b>(24,235,143)</b>	<b>4,219,638</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Increase in demand, NOW, money market, and savings deposits, net	14,847,853	9,023,227	7,626,004
Increase (decrease) in time deposits, net	10,708,205	(24,486,836)	(19,215,560)
Increase (decrease) in borrowings, net	2,500,000	(1,000,000)	-
Sale of common stock	-	6,000,000	-
<b>Net cash provided by (used in) financing activities</b>	<b>28,056,058</b>	<b>(10,463,609)</b>	<b>(11,589,556)</b>
<b>Net decrease in cash and cash equivalents</b>	<b>(2,336,765)</b>	<b>(28,285,663)</b>	<b>(773,456)</b>
<b>Cash and cash equivalents, beginning</b>	<b>17,946,468</b>	<b>46,232,131</b>	<b>47,005,587</b>
<b>Cash and cash equivalents, ending</b>	<b>\$ 15,609,703</b>	<b>\$ 17,946,468</b>	<b>\$ 46,232,131</b>

*The Notes to Consolidated Financial Statements are an integral part of these consolidated financial statements.*

(Continued)

**DELMAR BANCORP**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**Years Ended December 31, 2014, 2013, and 2012**  
**(Continued)**

	2014	2013	2012
<b>Supplementary cash flow information:</b>			
Interest paid	\$ 2,206,214	\$ 2,713,529	\$ 3,995,854
Income taxes paid	34,400	8,400	278,400
Total appreciation (depreciation) on securities available for sale	771,248	(722,569)	(152,133)
<b>SUPPLEMENTARY NON-CASH INVESTING ACTIVITIES</b>			
Loans converted to other real estate owned	\$ 3,004,054	\$ 2,312,639	\$ 847,831

*The Notes to Consolidated Financial Statements are an integral part of these consolidated financial statements.*

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### **Note 1. The Company and Its Significant Accounting Policies**

The Bank provides financial services to individuals and corporate customers, and is subject to competition from other financial institutions. The Bank is also subject to the regulations of certain Federal and state agencies and undergoes periodic examinations by those regulatory authorities. The accounting policies of the Bank conform to generally accepted accounting principles and general practices within the banking industry.

Significant accounting policies not disclosed elsewhere in the consolidated financial statements are as follows:

#### **Principles of Consolidation:**

The consolidated financial statements include the accounts of Delmar Bancorp, a bank holding company (the Company); its wholly owned subsidiaries - The Bank of Delmarva (the "Bank"), a commercial bank engaged in general commercial banking operations in Maryland and Delaware, and Eastern Shore Insurance Holdings, Inc. formerly known as Hanna, Kremer & Tilghman Insurance, Inc., an inactive company formerly engaged in the sale of insurance products, which sold its primary assets on October 14, 2011 and was dissolved and liquidated in 2013; Delmarva Real Estate Holdings, LLC., a wholly owned subsidiary of The Bank of Delmarva, which is a real estate holding company; DHB Development, LLC, of which the Bank holds a 40.55% interest, and is a real estate holding company; West Nithsdale Enterprises, LLC, of which the Bank holds a 10% interest, and is a real estate holding company; and Salisbury Housing, LLC, of which the Bank holds 50% interest, and is also a real estate holding company. All significant intercompany accounts and transactions have been eliminated.

#### **Accounting Standards Codification:**

The Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) became effective on July 1, 2009. At that date, the ASC became FASB's officially recognized source of authoritative U.S. generally accepted accounting principles (GAAP) applicable to all public and non-public non-governmental entities, superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF) and related literatures. Rules and interpretive releases of the SEC under the authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. All other accounting literature is considered non-authoritative. The switch to ASC affects the way companies refer to U.S. GAAP in financial statements and accounting policies. Citing particular content in the ASC involves specifying the unique numeric path to the content through the Topic, Subtopic, Section and Paragraph structure.

#### **Use of Estimates:**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted within the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### **Securities Held to Maturity:**

Bonds, notes, and debentures classified as held to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity. Securities transferred into held to maturity from the available for sale portfolio are recorded at fair value at time of transfer with unrealized gains or losses reflected in equity and amortized over the remaining life of the security.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 1. The Company and Its Significant Accounting Policies (Continued)

#### Securities Available for Sale:

Marketable debt and equity securities not classified as held to maturity are classified as available for sale. Securities available for sale are acquired as part of the Bank's asset/liability management strategy and may be sold in response to changes in interest rates, loan demand, changes in prepayment risk, and other factors. Securities available for sale are carried at fair value as determined by quoted market prices. Unrealized gains or losses based on the difference between amortized cost and fair value are reported in other comprehensive income, net of deferred tax. Realized gains and losses, using the specific identification method, are included as a separate component of other income (expense) and, when applicable, are reported as a reclassification adjustment, net of tax, in other comprehensive income. Premiums and discounts are recognized in interest income using the interest method over the period to maturity. Additionally, declines in the fair value of individual investment securities below their cost that are other than temporary are reflected as realized losses in the consolidated statements of income.

#### Other Securities:

Federal Home Loan Bank ("FHLB"), Atlantic Central Bankers Bank ("ACBB"), and Maryland Financial Bank ("MFB") are equity interests in the FHLB, ACBB, and MFB respectively. These securities do not have a readily determinable fair value for purposes of ASC 320-10 Investments-Debt and Equity Securities because their ownership is restricted and they lack an active market. As there is no readily determinable fair value for these securities, they are carried at cost less any other-than-temporary impairment (OTTI). Other Investments consists of an equity ownership of Solomon Hess SBA Loan Fund LLC which the value is adjusted for its prorata share of assets in the Fund.

#### Loans and the Allowance for Credit Losses:

Loans are generally carried at the amount of unpaid principal, adjusted for unearned loan fees, which are amortized over the term of the loan using the effective interest rate method. Interest on loans is accrued based on the principal amounts outstanding. It is the Bank's policy to discontinue the accrual of interest when a loan is specifically determined to be impaired or when principal or interest is delinquent for ninety days or more. When a loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Interest income generally is not recognized on specific impaired loans unless the likelihood of further loss is remote. Cash collections on such loans are applied as reductions of the loan principal balance and no interest income is recognized on those loans until the principal balance has been collected. Interest income on other nonaccrual loans is recognized only to the extent of interest payments received. The carrying value of impaired loans is based on the present value of the loan's expected future cash flows or, alternatively, the observable market price of the loan or the fair value of the collateral.

The allowance for loan losses is maintained at a level believed adequate by management to absorb probable losses inherent in the loan portfolio and is based on the size and current risk characteristics of the loan portfolio, an assessment of individual problem loans and actual loss experience, the value of the underlying collateral, and current economic events in specific industries and geographical areas, including unemployment levels, and other pertinent factors, including regulatory guidance and general economic conditions. Determination of the allowance is inherently subjective, as it requires significant estimates, including the amounts and timing on historical loss experience, and consideration of current economic trends, all of which may be susceptible to significant change. Loan losses are charged off against the allowance, while recoveries of amounts previously charged off are credited to the allowance. A provision for credit losses is charged to operations based on management's periodic evaluation of the factors previously mentioned, as well as other pertinent factors. Evaluations are conducted at least monthly and more often if deemed necessary.

The allowance for credit losses typically consists of an allocated component and an unallocated component. The allocated component of the allowance for credit losses reflects expected losses resulting from analyses developed through specific credit allocations for individual loans and historical loss experience for each loan category.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 1. The Company and Its Significant Accounting Policies (Continued)

The specific credit allocations are based on regular analyses of all loans over a fixed-dollar amount where the internal credit rating is at or below a predetermined classification. The historical loan loss element is determined statistically using an informal loss migration analysis that examines loss experience and the related internal gradings of loans charged off over a current 3 year period. The loss migration analysis is performed quarterly and loss factors are updated regularly based on actual experience. The allocated component of the allowance for credit losses also includes consideration of concentrations and changes in portfolio mix and volume.

Any unallocated portion of the allowance reflects management's estimate of probable inherent but undetected losses within the portfolio due to uncertainties in economic conditions, delays in obtaining information, including unfavorable information about a borrower's financial condition, the difficulty in identifying triggering events that correlate perfectly to subsequent loss rates, and risk factors that have not yet manifested themselves in loss allocation factors. In addition, the unallocated allowance includes a component that explicitly accounts for the inherent imprecision in loan loss migration models. The historical losses used in the migration analysis may not be representative of actual unrealized losses inherent in the portfolio. It is management's intent to continually refine the methodology for the allowance for credit losses in an attempt to directly allocate potential losses in the loan portfolio under ASC Topic 310 and minimize the unallocated portion of the allowance for credit losses.

#### Loan Charge-off Policies

Loans are generally fully or partially charged down to the fair value of securing collateral when:

- management deems the asset to be uncollectible
- repayment is deemed to be made beyond the reasonable time frames
- the asset has been classified as a loss by internal or external review
- the borrower has filed bankruptcy and the loss becomes evident owing to a lack of assets

#### **Other Real Estate Owned (OREO):**

OREO comprises properties acquired in partial or total satisfaction of problem loans. The properties are recorded at the lower of cost or fair value at the date acquired. Losses arising at the time of acquisition of such properties are charged against the allowance for credit losses. Subsequent write-downs that may be required and expenses of operation are included in other expenses. Gains and losses realized from the sale of OREO are included in other income. At December 31, 2014 there were fifteen properties with a combined value of **\$3,722,569** included in other real estate owned, and at December 31, 2013 there were eighteen properties with a combined value of \$3,164,152.

#### **Bank Premises and Equipment and Depreciation:**

Bank premises and equipment are stated at cost less accumulated depreciation. The provision for depreciation is computed using primarily the straight-line method over the estimated useful lives of the assets, ranging from two to fifty years. Leasehold improvements are depreciated over the lesser of the terms of the leases or their estimated useful lives. Expenditures for improvements that extend the life of an asset are capitalized and depreciated over the asset's remaining useful life. Gains or losses realized on the disposition of premises and equipment are reflected in the consolidated statements of income. Expenditures for repairs and maintenance are charged to other expenses as incurred. Computer software is recorded at cost and amortized over three to five years.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 1. The Company and Its Significant Accounting Policies (Continued)

#### Intangible Assets and Amortization:

The Bank's intangible assets consisting primarily of a premium paid in the acquisition of branch operations, loans, and deposits from another financial institution in November 1997 were amortized over 10 years. This asset was fully amortized in 2007. The Bank more recently acquired a core deposit intangible asset relating to a branch acquisition which occurred in September 2008 (see Note 18). The intangible asset of \$421,248 is being amortized on a straight-line basis primarily over seven years.

#### Long-Lived Assets:

The carrying value of long-lived assets and certain identifiable intangibles is reviewed by management for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable as prescribed by ASC 360-10 Property, Plant, and Equipment. As of December 31, 2014, certain loans (see Note 3) were deemed to be impaired. As of December 31, 2013, certain loans (see Note 3) and investment securities (see Note 2) were deemed to be impaired.

#### Income Taxes:

The Company and its subsidiaries file a consolidated Federal tax return. The provision for Federal and state income taxes is based upon the consolidated results of operations, adjusted for tax-exempt income. Deferred income taxes are provided under ASC 740-10 Income Taxes by applying enacted statutory rates to temporary differences between financial and tax bases of assets and liabilities.

Temporary differences, which give rise to deferred tax assets relate principally to the allowance for credit losses, accumulated amortization of intangibles, impairment loss on securities, net operating loss carryforward, net losses on other real estate owned, and unrealized depreciation on securities available for sale. Temporary differences which give rise to deferred tax liabilities relate to accumulated depreciation, deferred gains and accumulated accretion of discount on debt securities.

#### Securities Sold Under Agreements to Repurchase:

Securities sold under agreements to repurchase are comprised of six customer deposit agreements with various maturities, totaling **\$1,839,846** at December 31, 2014 and **\$1,761,584** at December 31, 2013. This obligation is not federally insured, but is collateralized by investment securities. These pledged securities are segregated and maintained by a third-party institution. The amortized cost and fair value of these securities at December 31, 2014 was **\$4,499,032** and **\$4,430,655**, respectively. The amortized cost and fair value of these securities at December 31, 2013 was **\$4,498,785** and **\$4,285,945**, respectively.

#### Credit Risk:

The Bank has deposits in other financial institutions in excess of amounts insured by the Federal Deposit Insurance Corporation (FDIC).

#### Cash and Cash Equivalents:

The Bank has included cash and due from banks, interest bearing deposits in other financial institutions, and Federal funds sold as cash and cash equivalents for purposes of reporting cash flows.

#### Accounting for Stock Based Compensation:

The Company follows ASC 718-10 Compensation – Stock Compensation for accounting and reporting for stock-based compensation plans. ASC 718-10 defines a fair value at grant date to be used for measuring compensation expense for stock-based compensation plans to be recognized in the statement of operations.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 1. The Company and Its Significant Accounting Policies (Continued)

#### Earnings (Loss) Per Common Share:

Basic earnings (loss) per common share are determined by dividing net income (loss) adjusted for preferred stock dividends declared and/or accumulated and accretion of warrants by the weighted average number of shares outstanding for each year, giving retroactive effect to stock splits and dividends. Weighted average shares outstanding were **8,116,066**, 5,409,247, and 4,866,066 for the years ended December 31, 2014, 2013, and 2012, respectively. Calculations of diluted earnings (loss) per common share include the average dilutive common stock equivalents outstanding during the year, unless they are anti-dilutive. Dilutive common equivalent shares consist of stock options calculated using the treasury stock method. (See Note 14).

#### Financial Statement Presentation

Certain amounts in the prior years' financial statements have been reclassified to conform to the current year's presentation.

### Note 2. Investment Securities

December 31, 2014				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Obligations of U.S. Government agencies and corporations	\$ 8,354,230	\$ 4,881	\$ (86,024)	\$ 8,273,087
Obligations of States and political subdivisions	10,998,418	546,880	(12,437)	11,532,861
Mortgage-backed securities	12,989,569	158,140	(168,516)	12,979,193
Equity securities	1,000,000	-	(38,345)	961,655
	\$ 33,342,217	\$ 709,901	\$ (305,322)	\$ 33,746,796
December 31, 2013				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Obligations of U.S. Government agencies and corporations	\$ 6,338,648	\$ 3,320	\$ (257,828)	\$ 6,084,140
Obligations of States and political subdivisions	11,265,759	302,861	(160,826)	11,407,794
Mortgage-backed securities	18,325,312	151,102	(363,719)	18,112,695
Equity securities	1,000,000	-	(49,943)	950,057
Other securities	1,085,000	8,362	-	1,093,362
	\$ 38,014,719	\$ 465,645	\$ (832,316)	\$ 37,648,048

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 2. Investment Securities (Continued)

Gross unrealized losses and fair values, aggregated by investment category and length of time that individual securities have been in continuous unrealized loss position, at December 31, 2014 are as follows:

Securities available-for-sale:

	December 31, 2014					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Obligations of U.S. Government agencies and corporations	\$ 1,006,430	\$ 2,259	\$ 5,255,157	\$ 83,765	\$ 6,261,587	\$ 86,024
Mortgage-backed securities	807,844	3,098	4,039,423	165,418	4,847,267	168,516
Obligations of States and political subdivisions	1,471,918	7,762	674,913	4,675	2,146,831	12,437
Equity Securities	-	-	961,654	38,345	961,654	38,345
Total securities with unrealized losses	\$ 3,286,192	\$ 13,119	\$ 10,931,147	\$ 292,203	\$ 14,217,339	\$ 305,322

For individual securities classified as either available for sale or held to maturity, the Bank must determine whether a decline in fair value below the amortized cost basis is other than temporary. In estimating other-than-temporary impairment losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. If the decline in fair value is considered to be other than temporary, the cost basis of the individual security shall be written down to the fair value as a new cost basis and the amount of the write-down shall be included in earnings (that is, accounted for as a realized loss).

The Company recognized \$3,554,942 and \$130,500 in 2013 and 2012, respectively, of pre-tax other-than-temporary impairment losses related to \$5,500,000 (original face) of trust preferred securities (TRUPs) issued by financial institutions. The other-than-temporary losses represent management's estimate of credit losses inherent in the securities considering projected cash flows using assumption of deferral and default rates, prepayment assumptions, loss severities, and future recoveries.

The following table presents a rollforward of the cumulative other-than-temporary credit losses recognized in earnings for all debt securities held at year end for which a portion of an other-than-temporary loss was recognized in accumulated other comprehensive loss:

Rollforward of Cumulative Other-Than-Temporary Investment Credit Losses Recognized in Earnings (a)			
	2014	2013	2012
Estimated credit losses - beginning balance	\$ 4,560,442	\$ 1,005,500	\$ 875,000
Additions for credit losses not previously recognized	-	3,554,942	130,500
Reductions for realized losses	(4,560,442)	-	-
Estimated credit losses - ending balance	\$ -	\$ 4,560,442	\$ 1,005,500

(a) Excludes other-than-temporary investment credit losses related to equity securities.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 2. Investment Securities (Continued)

During 2012, after management reviewed its investments in TRUPs, the expected discounted cash flows resulted in shortfalls, resulting in a total other than temporary impairment loss of \$130,500, which is reflected in other expenses.

During 2013, after management reviewed its investments in TRUPs it was determined to write the securities down to net realizable value by \$3,554,562, which is reflected in other expenses. The other-than-temporary losses represented management's estimate of credit losses inherent in the securities considering projected cash flows and the lack of a market as of December 31, 2013.

During 2014 the Company sold its TRUPs holdings. The sale resulted in net gains before taxes of **\$1,675,219** and approximately **\$1,014,000** after taxes. During 2014 a market unexpectedly developed for the TRUPs that allowed the Company to dispose of the securities.

At December 31, 2014 there were four obligations of U.S. Government Agency (Agencies), three mortgage-backed securities (MBS), four municipal investments (MUNIs), and one equity investment that had been in a continuous unrealized loss position for more than twelve months. As of December 31, 2014, management also believes it has the ability and intent to hold the securities for a period of time sufficient for a recovery of cost.

During 2014 the Bank sold 14 securities, resulting in a net gain of \$1,667,779. During 2013 the Bank sold one security, resulting in a gain of \$21,500. During 2012, the Bank sold four securities, resulting in net gains of \$44,674. Seven securities were either matured or called during 2014, resulting in no gain or loss. Six securities were either matured or called during 2013, resulting in a net gain of \$6,200. Ten securities were either matured or called during 2012, of which two resulted in a gain of \$1,864.

Contractual maturities of investment securities at December 31, 2014 and 2013 are shown below. Actual maturities may differ from contractual maturities because debtors may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities have no stated maturity and primarily reflect investments in various Pass-through and Participation Certificates issued by the Federal National Mortgage Association and the Government National Mortgage Association. Repayment of mortgage-backed securities is affected by the contractual repayment terms of the underlying mortgages collateralizing these obligations and the current level of interest rates.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 2. Investment Securities (Continued)

The following is a summary of maturities, calls, or repricing of securities available for sale:

<b>December 31, 2014</b>		
	Securities Available for Sale	
	Amortized Cost	Fair Value
Due in one year or less	\$ -	\$ -
Due after one year through five years	6,354,230	6,315,427
Due after five years through ten years	11,457,042	11,865,840
Due after ten years or more	2,541,376	2,586,336
Mortgage-backed, due in monthly installments	12,989,569	12,979,193
	<b>\$ 33,342,217</b>	<b>\$ 33,746,796</b>

  

<b>December 31, 2013</b>		
	Securities Available for Sale	
	Amortized Cost	Fair Value
Due in one year or less	\$ 902,297	\$ 927,946
Due after one year through five years	4,338,648	4,215,640
Due after five years through ten years	6,346,960	6,317,173
Due after ten years or more	8,101,818	8,074,910
Mortgage-backed, due in monthly installments	18,324,996	18,112,379
	<b>\$ 38,014,719</b>	<b>\$ 37,648,048</b>

The Bank has pledged certain securities as collateral for qualified customers' deposit accounts at December 31, 2014 and 2013 as follows:

	<b>2014</b>	<b>2013</b>
Amortized cost	<b>\$ 7,625,648</b>	<b>\$ 7,453,265</b>
Fair value	<b>7,987,498</b>	<b>7,496,786</b>

The Bank has also pledged securities with the Federal Reserve Bank ("FRB") to collateralize its accounts held at the FRB with an amortized cost and fair value of \$207,881 and \$219,830, respectfully.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 3. Loans and Allowance for Credit Losses

#### Allowance for Loan Losses

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Bank has segmented the loan portfolio into the following classifications:

- Other Real Estate Secured
  - Commercial Real Estate
  - Construction and Land Development
  - Farmland
  - Multifamily
- 1 – 4 Family Residential Secured
- Other
  - Commercial and Industrial
  - Consumer Loans
  - Other Loans

Each of these segments are reviewed and analyzed quarterly using the weighted average historical charge-offs over a current three year period for their respective segments as well as the following qualitative factors:

- Changes in the levels and trends in delinquencies, nonaccruals, classified assets and troubled debt restructurings
- Changes in the nature and volume of the portfolio
- Effects of any changes in lending policies, procedures, including underwriting standards and collections, charge off and recovery practices
- Changes in the experience, depth and ability of management
- Changes in the national and local economic conditions and developments, including the condition of various market segments
- Changes in the concentration of credits within each pool
- Changes in the quality of the Bank's loan review system and the degree of oversight by the Board
- Changes in external factors such as competition and the legal environment

The above factors result in a FAS 5, as codified in FASB ASC 450-10- 20, calculated reserve for environmental factors.

All credit exposures graded at a rating of "5", "6", "7" or "8" with outstanding balances less than \$250,000 and credit exposures graded at a rating of "1", "2", "3" or "4" are reviewed and analyzed quarterly using the weighted average historical charge-offs over a current three year period as a percentage of total charge-offs for the same period for their respective segments as well as the qualitative factors discussed above. The weighted average historical percentage is further adjusted based on delinquency risk trend assessments and concentration risk assessments.

All credit exposures graded at a rating of "5", "6", "7" or "8" with outstanding balances greater than \$250,000 are to be reviewed no less than quarterly for the purpose of determining if a specific allocation is needed for that credit. The determination for a specific reserve is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases management uses the current fair value of the collateral, less selling cost when foreclosure is probable, instead of discounted cash flows. If management determines that the value of the loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 3. Loans and Allowance for Credit Losses (Continued)

The establishment of a specific reserve does not necessarily mean that the credit with the specific reserve will definitely incur loss at the reserve level. It is only an estimation of potential loss based upon anticipated events. A specific reserve will not be established unless loss elements can be determined and quantified based on known facts.

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio as of December 31, 2014 and 2013.

The following table presents the total allowance by loan segment.

	Other Real Estate Secured	1 - 4 Family Residential Secured	Other	Unallocated	Total
<b>Balance at December 31, 2013</b>	<b>\$ 4,287,924</b>	<b>\$ 2,411,000</b>	<b>\$ 983,000</b>	<b>\$ 615,000</b>	<b>\$ 8,296,924</b>
Charge-offs	(1,231,841)	(579,376)	(386,514)	-	(2,197,731)
Recoveries	455,998	142,703	87,493	-	686,194
Provision	903,306	217,673	86,021	193,000	1,400,000
<b>Balance at December 31, 2014</b>	<b>\$ 4,415,387</b>	<b>\$ 2,192,000</b>	<b>\$ 770,000</b>	<b>\$ 808,000</b>	<b>\$ 8,185,387</b>
<b>Individually evaluated for impairment:</b>					
Balance in allowance	\$ 738,999	\$ 47,832	\$ 311,632	\$ -	\$ 1,098,463
Related loan balance	17,046,771	4,524,260	407,260	-	21,978,291
<b>Collectively evaluated for impairment:</b>					
Balance in allowance	\$ 3,676,389	\$ 2,144,168	\$ 458,368	\$ -	\$ 7,086,924
Related loan balance	228,118,658	97,599,777	38,555,561	-	364,273,996

  

	Other Real Estate Secured	1 - 4 Family Residential Secured	Other	Unallocated	Total
<b>Balance at December 31, 2012</b>	<b>\$ 4,315,975</b>	<b>\$ 1,957,000</b>	<b>\$ 461,001</b>	<b>\$ -</b>	<b>\$ 6,733,976</b>
Charge-offs	(4,667,353)	(3,343,682)	(417,413)	-	(8,428,448)
Recoveries	78,963	26,245	92,188	-	197,396
Provision	4,560,339	3,771,437	847,224	615,000	9,794,000
<b>Balance at December 31, 2013</b>	<b>\$ 4,287,924</b>	<b>\$ 2,411,000</b>	<b>\$ 983,000</b>	<b>\$ 615,000</b>	<b>\$ 8,296,924</b>
<b>Individually evaluated for impairment:</b>					
Balance in allowance	\$ 1,012,578	\$ 465,231	\$ 615,422	\$ -	\$ 2,093,231
Related loan balance	20,660,210	5,769,769	688,340	-	27,118,319
<b>Collectively evaluated for impairment:</b>					
Balance in allowance	\$ 3,275,346	\$ 1,945,769	\$ 367,578	\$ 615,000	\$ 6,203,693
Related loan balance	202,158,103	88,004,440	29,044,363	-	319,206,906

The Bank had an unallocated amount (overage) of approximately \$808,000 in the allowance that is reflected in the above table as of December 31, 2014. The Bank had an unallocated amount (overage) of approximately \$615,000 in the allowance that is reflected in the above table as of December 31, 2013. Management is comfortable with this amount as they feel it is adequate to absorb additional inherent potential losses in the loan portfolio as further detailed in Note 1, "Loans and the Allowance for Credit Losses".



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 3. Loans and Allowance for Credit Losses (Continued)

#### Credit Quality Information

The following table represents credit exposures by creditworthiness category for the year ending December 31, 2014. The use of creditworthiness categories to grade loans permits management to estimate a portion of credit risk. The Bank's internal creditworthiness is based on experience with similarly graded credits. Loans that trend upward toward higher credit grades typically have less credit risk and loans that migrate downward typically have more credit risk.

The Bank's internal risk ratings are as follows:

- 1 Excellent – minimal risk. (normally supported by pledged deposits, United States government securities, etc.)
- 2 Superior – low risk. (all of the risks associated with this credit based on each of the bank's creditworthiness criteria are minimal)
- 3 Good – moderately low risk. (most of the risks associated with this credit based on each of the bank's creditworthiness criteria are minimal)
- 4 Fair/Watch – moderate risk. (the weighted overall risk associated with this credit based on each of the bank's creditworthiness criteria is acceptable)
- 5 Marginal – moderately high risk. (possesses deficiencies which corrective action by the bank would remedy; potential watch list)
- 6 Substandard – (the bank is inadequately protected and there exists the distinct possibility of sustaining some loss if not corrected)
- 7 Doubtful – (weaknesses make collection or liquidation in full, based on currently existing facts, improbable)
- 8 Loss – (of little value; not warranted as a bankable asset)

#### Non-accruals

In general, a loan will be placed on non-accrual status at the end of the reporting month in which the interest or principal is past due more than 90 days. Exceptions to the policy are those loans that are in the process of collection and are well secured. A well-secured loan is secured by collateral with sufficient market value to repay principal and all accrued interest.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 3. Loans and Allowance for Credit Losses (Continued)

December 31, 2014	Other Real Estate Secured	1-4 Family Residential Secured	Other	Total
Excellent	\$ 745,004	\$ -	\$ 369,021	\$ 1,114,025
Superior	5,330,385	-	685,002	6,015,387
Good	213,315,614	91,460,792	36,452,018	341,228,424
Fair	14,707,480	6,704,406	572,250	21,984,136
Marginal	3,504,354	271,008	135,946	3,911,308
Substandard	7,562,592	3,687,831	748,584	11,999,007
<b>TOTAL</b>	<b>\$ 245,165,429</b>	<b>\$ 102,124,037</b>	<b>\$ 38,962,821</b>	<b>\$ 386,252,287</b>
Non-Accrual	\$ 3,138,635	\$ 2,520,219	\$ 382,251	\$ 6,041,105
Troubled debt restructures	\$ 14,327,350	\$ 3,719,686	\$ 275,955	\$ 18,322,991
Number of TDR accounts	28	17	3	48
<b>Breakdown of TDRs</b>				
TDRs on Nonaccrual	\$ 1,178,570	\$ 1,245,871	\$ 66,049	\$ 2,490,490
TDRs Past Due 30-89	-	707,322	-	707,322
Performing TDRs	13,148,780	1,766,493	209,906	15,125,179
<b>TOTAL</b>	<b>\$ 14,327,350</b>	<b>\$ 3,719,686</b>	<b>\$ 275,955</b>	<b>\$ 18,322,991</b>
Total Non-performing TDR accounts	\$ 1,178,570	\$ 1,953,193	\$ 66,049	\$ 3,197,812
Number of non-performing TDRs	5	9	1	15
December 31, 2013	Other Real Estate Secured	1-4 Family Residential Secured	Other	Total
Excellent	\$ 241,295	\$ -	\$ 504,027	\$ 745,322
Superior	4,041,605	-	269,030	4,310,635
Good	181,434,360	77,206,262	27,377,517	286,018,139
Fair	22,158,221	10,818,648	601,311	33,578,180
Marginal	2,535,329	164,840	48,963	2,749,132
Substandard	12,407,502	5,584,459	931,856	18,923,817
<b>TOTAL</b>	<b>\$ 222,818,312</b>	<b>\$ 93,774,209</b>	<b>\$ 29,732,704</b>	<b>\$ 346,325,225</b>
Non-Accrual	\$ 2,526,793	\$ 3,886,772	\$ 274,292	\$ 6,687,857
Troubled debt restructures	\$ 19,070,405	\$ 4,949,556	\$ 217,325	\$ 24,237,286
Number of TDR accounts	34	22	3	59
<b>Breakdown of TDRs</b>				
TDRs on Nonaccrual	\$ 1,289,928	\$ 2,687,746	\$ 115,700	\$ 4,093,374
TDRs Past Due 30-89	2,104,458	1,118,095	-	3,222,553
Performing TDRs	15,676,019	1,143,714	101,625	16,921,359
<b>TOTAL</b>	<b>\$ 19,070,405</b>	<b>\$ 4,949,555</b>	<b>\$ 217,325</b>	<b>\$ 24,237,286</b>
Total Non-performing TDR accounts	\$ 3,394,386	\$ 3,805,842	\$ 115,700	\$ 7,315,927
Number of non-performing TDRs	11	13	1	25

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 3. Loans and Allowance for Credit Losses (Continued)

The following table includes an aging analysis of the recorded investment of past due financing receivables as of December 31, 2014 and 2013:

December 31, 2014	30-59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due *	Total Past Due	Current Balance	Total Financing Receivables	Recorded Investment > 90 Days Past Due and Accruing
Other Real Estate Secured	\$ 736,428	\$ 565,674	\$ 3,138,635	\$ 4,440,737	\$ 240,724,691	\$ 245,165,429	\$ -
1 - 4 Family Residential	1,720,820	394,262	2,581,552	4,696,634	97,427,403	102,124,037	61,333
Other	274,002	17,841	394,480	686,323	38,276,499	38,962,821	12,229
<b>TOTAL</b>	<b>\$ 2,731,250</b>	<b>\$ 977,777</b>	<b>\$ 6,114,667</b>	<b>\$ 9,823,694</b>	<b>\$ 376,428,593</b>	<b>\$ 386,252,287</b>	<b>\$ 73,562</b>

\* Includes \$6,041,105 of non-accrual loans.

December 31, 2013	30-59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due *	Total Past Due	Current Balance	Total Financing Receivables	Recorded Investment > 90 Days Past Due and Accruing
Other Real Estate Secured	\$ 2,753,925	\$ 1,019,484	\$ 2,526,795	\$ 6,300,204	\$ 216,518,109	\$ 222,818,313	\$ -
1 - 4 Family Residential	2,324,952	529,568	3,886,771	6,741,291	87,032,918	93,774,209	-
Other	609,547	8,896	279,469	897,912	28,834,791	29,732,703	5,177
<b>TOTAL</b>	<b>\$ 5,688,424</b>	<b>\$ 1,557,948</b>	<b>\$ 6,693,035</b>	<b>\$ 13,939,407</b>	<b>\$ 332,385,818</b>	<b>\$ 346,325,225</b>	<b>\$ 5,177</b>

\* Includes \$6,687,857 of non-accrual loans.

#### Impaired Loans

Impaired loans are defined as nonaccrual loans, troubled debt restructurings, and loans risk rated a "6" or above. When management identifies a loan as impaired, the impairment is measured for potential loss based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases management used the current fair value of the collateral, less selling cost when foreclosure is probable, instead of discounted cash flows. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance.

When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is on nonaccrual status, all payments are applied to principal, under the cost recovery method. When the ultimate collectability of the total principal of an impaired loan is not in doubt and the loan is on nonaccrual status, contractual interest is credited to interest income when received, under the cash basis method.

The following table includes the recorded investment and unpaid principal balances for impaired financing receivables with the associated allowance amount, if applicable. Management determined the specific reserve in the allowance based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the remaining source of repayment for the loan is the operation or liquidation of the collateral. In those cases, the current fair value of the collateral, less selling costs was used to determine the specific allowance recorded.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 3. Loans and Allowance for Credit Losses (Continued)

Also presented are the average recorded investments in the impaired loans and the related amount of interest recognized during the time within the period that the impaired loans were impaired. When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is on nonaccrual status, all payments are applied to principal, under the cost recovery method.

December 31, 2014	Recorded Investment	Unpaid Principal Balance	Interest Income Recognized	Specific Reserve	Average Recorded Investment
Impaired loans with specific reserves:					
Other Real Estate Secured	\$ 6,077,160	\$ 6,112,160	\$ 306,221	\$ 738,999	\$ 7,105,844
1 - 4 Family Residential Secured	1,078,730	1,078,730	37,184	47,832	1,907,004
Other	381,632	381,632	15,389	311,632	498,527
Total impaired loans with specific reserves	\$ 7,537,522	\$ 7,572,522	\$ 358,794	\$ 1,098,463	\$ 9,511,375
Impaired loans with no specific reserve:					
Other Real Estate Secured	\$ 11,011,609	\$ 12,379,963	\$ 921,954	-	\$ 12,618,217
1 - 4 Family Residential Secured	3,445,530	4,389,777	55,237	-	3,528,870
Other	392,580	404,380	21,343	-	405,319
Total impaired loans with no specific reserve	\$ 14,849,719	\$ 17,174,120	\$ 998,534	-	\$ 16,552,406
TOTAL	\$ 22,387,241	\$ 24,746,642	\$ 1,357,328	\$ 1,098,463	\$ 26,063,781

Total impaired loans of \$22,387,241 at December 31, 2014 include \$408,950 of loans which did not meet the criteria whereby an individual evaluation for impairment was required. These loans were pooled with all other loans not requiring an evaluation for individual impairment and reviewed and analyzed using the weighted average historical charge-offs over a current three year period for their respective segments along with the qualitative factors stated previously in this disclosure, to result in a FAS 5 calculated reserve.

December 31, 2013	Recorded Investment	Unpaid Principal Balance	Interest Income Recognized	Specific Reserve	Average Recorded Investment
Impaired loans with specific reserves:					
Other Real Estate Secured	\$ 8,134,528	\$ 8,306,357	\$ 232,156	\$ 1,012,578	\$ 9,910,877
1 - 4 Family Residential Secured	2,735,277	2,735,277	124,382	465,231	4,127,962
Other	615,422	615,422	25,939	615,422	323,545
Total impaired loans with specific reserves	\$ 11,485,227	\$ 11,657,056	\$ 382,477	\$ 2,093,231	\$ 14,362,384
Impaired loans with no specific reserve:					
Other Real Estate Secured	\$ 14,224,825	\$ 16,958,894	\$ 685,022	-	\$ 16,112,485
1 - 4 Family Residential Secured	3,612,210	5,534,039	62,795	-	3,567,117
Other	418,058	418,058	21,521	-	591,115
Total impaired loans with no specific reserve	\$ 18,255,093	\$ 22,910,991	\$ 769,338	-	\$ 20,270,717
TOTAL	\$ 29,740,320	\$ 34,568,047	\$ 1,151,815	\$ 2,093,231	\$ 34,633,101

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 3. Loans and Allowance for Credit Losses (Continued)

The Bank makes loans to customers located primarily within Wicomico and Worcester Counties, Maryland and Sussex County, Delaware. A substantial portion of its loan portfolio consists of residential and commercial real estate mortgages.

Included in the amounts listed above are loans receivable from directors, principal officers, and stockholders of **\$8,345,000** and \$3,454,000 at December 31, 2014 and 2013, respectively. During 2014 and 2013, loan additions totaled **\$5,415,000** and \$883,000, respectively. During 2014 and 2013 repayments totaled **\$524,000** and \$1,524,000, respectively. These loans were made in the ordinary course of business on substantially the same terms and conditions as those prevailing at the same time for comparable transactions with other customers, including interest rates and collateral. They do not involve more than normal risk of collectability or present other unfavorable terms.

The Bank had one commitment to loan additional funds to the borrowers of restructured, impaired, or non-accrual loans as of December 31, 2014 totaling approximately \$80,000.

### Note 4. Premises, Equipment and Depreciation

A summary of premises and equipment, at cost, and accumulated depreciation is as follows:

	2014	2013
Land	\$ 1,752,560	\$ 1,752,560
Buildings and improvements	6,434,569	6,434,569
Furniture and equipment	6,533,625	5,928,859
Total premises and equipment	14,720,754	14,115,988
Less: accumulated depreciation	7,345,486	6,820,080
Net premises and equipment	\$ 7,375,268	\$ 7,295,908

Depreciation expense totaled **\$560,717**, \$542,118, and \$579,903 for the years ended December 31, 2014, 2013, and 2012, respectively.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 5. Income Taxes

Components of income tax expense (benefit) for each of the three years ended December 31, 2014, 2013, and 2012 are as follows:

	2014	2013	2012
Current			
Federal	\$ 5,523	\$ 64,446	\$ (34,698)
State	-	24,581	(30,416)
Total current	5,523	89,027	(65,114)
Deferred income tax benefits:			
Federal	1,570,355	(2,872,292)	207,195
State	364,740	(559,708)	55,231
Total deferred	1,935,095	(3,432,000)	262,426
Income tax expense (benefit)	\$ 1,940,618	\$ (3,342,973)	\$ 197,312

A reconciliation of tax computed at the Federal statutory income tax rate of 34% to the actual expense (benefit) for the years ended December 31, 2014, 2013, and 2012 is as follows:

	2014	2013	2012
Tax at Federal statutory income tax rate	\$ 1,193,088	\$ (3,027,443)	\$ 369,950
Tax effect of:			
Tax exempt income	(110,418)	(125,484)	(154,360)
Other	666,878	294,790	(77,525)
State income taxes, net of Federal tax benefit	191,070	(484,836)	59,247
Income tax expense (benefit)	\$ 1,940,618	\$ (3,342,973)	\$ 197,312

Income taxes included in the balance sheets are as follows:

	2014	2013
Federal income tax receivable	\$ -	\$ -
State franchise tax receivable	34,400	8,400
Deferred income tax benefits:		
Allowance for credit losses and unfunded commitments	\$ 801,177	\$ 1,104,940
Net operating loss carryforward	1,801,573	2,104,349
Accumulated amortization on intangibles	79,453	70,206
Impairment loss on investment securities	44,876	1,787,052
Net losses on other real estate owned	1,815,776	1,522,968
Stock-based compensation expense	143,192	49,485
Charitable contributions	30,451	22,011
Net unrealized depreciation on securities available for sale	-	144,620
	4,716,498	6,805,631
Deferred tax liabilities:		
Accumulated depreciation	291,633	297,930
Deferred gain	192,098	191,308
Accumulated securities discount accretion	8,212	4,218
Net unrealized appreciation on securities available for sale	159,598	-
	651,541	493,456
Net deferred income tax benefits	\$ 4,064,957	\$ 6,312,175

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 5. Income Taxes (Continued)

Management has determined that no valuation allowance is required as it is more likely than not that the deferred tax assets will be fully realizable in the future. At December 31, 2014 and 2013, management believes there are no uncertain tax positions under ASC Topic 740 Income Taxes. The Bank's Federal and state income tax returns are generally subject to examination by the IRS and/or state tax authorities for three years after they were filed. The tax return for 2011 was subject to a routine IRS examination in 2012, while 2012 and 2013 tax returns remain subject to future examination. The 2014 returns will be filed in 2015.

### Note 6. Deposits

Time deposits and their remaining maturities at December 31, 2014 are as follows:

2015	\$ 63,700,808
2016	49,742,213
2017	20,055,098
2018	15,793,214
2019	9,745,968
2019 and thereafter	46,459
Total time deposits	<u>\$ 159,083,760</u>

Interest expense on deposits for each of the years ended December 31, 2014, 2013, and 2012 is as follows:

	2014		2013		2012
NOW	\$ 22,102	\$	22,580	\$	27,693
Money market	119,499		139,135		317,727
Savings	59,744		65,148		84,084
Time, \$100,000 or more	634,576		791,138		1,051,677
Other time	1,043,611		1,246,461		1,665,081
	<u>\$ 1,879,532</u>	\$	<u>2,264,462</u>	\$	<u>3,146,262</u>

Deposit balances of officers and directors and their affiliated interests totaled approximately **\$3,753,000** and \$4,045,000 as of December 31, 2014 and 2013, respectively.

Deposit accounts in an overdraft position totaled approximately **\$181,000** and \$423,000 as of December 31, 2014 and 2013, respectively.

Some of the Company's CD deposits are through participation in the Certificate of Deposit Account Registry Service (CDARS). These deposits totaled **\$3,736,197** and \$3,175,389 at December 31, 2014 and 2013, respectively.

### Note 7. Other Income

Other income consists of the following:

	2014		2013		2012
Investment fees and commissions	\$ 245,443	\$	78,675	\$	159,300
Safe deposit box rentals	42,993		41,118		44,342
Visa debit income	636,197		601,070		520,384
Other non-interest income	788,895		675,864		643,202
	<u>\$ 1,468,085</u>	\$	<u>1,318,052</u>	\$	<u>1,207,928</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 8. Credit Facilities

The Bank owns capital stock of the Federal Home Loan Bank of Atlanta (FHLB) as a condition for a \$79,661,527 convertible advance credit facility from the FHLB.

At December 31, the Bank had \$6,500,000 in short-term borrowings under this arrangement with interest variable, 0.36% at December 31, 2014, and maturing within the next year.

In June 2005, the Bank borrowed \$5,000,000 from the FHLB with interest payable quarterly fixed at 3.78% through June 2010, maturing in June 2015. The FHLB had the option of converting the rate on this borrowing to a three month LIBOR based floating rate in 2010 however it chose not to do so, therefore the rate on this borrowing would have remained at 3.78% until maturity. During 2012 this borrowing was restructured to a three month LIBOR based floating rate for the first two years, then adjusting to 1.83% until maturity in December 2018. Due to a prepayment penalty of \$405,011, which is amortized to final maturity as an adjustment to interest expense, the effective rate is the three month LIBOR based floating rate plus 1.35% for the first two years, adjusting to 3.18% until maturity. The unamortized premium was \$268,713 as of December 31, 2014. In September 2005, the Bank borrowed an additional \$5,000,000 with interest payable quarterly fixed at 4.06% through September 2009, maturing in September 2015. The FHLB had the option of converting the rate on this borrowing to a three month LIBOR based floating rate in 2009 however it chose not to do so, therefore the rate on this borrowing would have remained at 4.06% until maturity. During 2012 this borrowing was restructured to a three month LIBOR based floating rate for the first two years, then adjusting to 1.83% until maturity in December 2018. Due to a prepayment penalty of \$500,195, which is amortized to final maturity as an adjustment to interest expense, the effective rate is the three month LIBOR based floating rate plus 1.67% for the first two years, adjusting to 3.50% until maturity. The unamortized premium was \$331,865 as of December 31, 2014. In September 2006, the Bank borrowed an additional \$5,000,000 with interest payable quarterly fixed at 4.57% through September 2011, maturing in September 2016. The FHLB had the option of converting the rate on this long-term borrowing to a three month LIBOR-based floating rate in 2011 however, it chose not to do so, therefore the rate on this borrowing would have remained at 4.57% until maturity. During 2012 this borrowing was restructured to a three month LIBOR based floating rate for the first two years, then adjusting to 1.83% until maturity in December 2018. Due to a prepayment penalty of \$740,365, which is amortized to final maturity as an adjustment to interest expense, the effective rate is the three month LIBOR based floating rate plus 2.47% for the first two years, adjusting to 4.30% until maturity. The unamortized premium was \$491,210 as of December 31, 2014. The Bank has pledged a portion of its residential and commercial mortgage loan portfolio as collateral for these credit facilities. Principal balances outstanding on these pledged loans totaled approximately **\$110,105,000** and \$87,189,500 at December 31, 2014 and 2013, respectively.

The proceeds of these long-term borrowings were generally used to purchase higher yielding investment securities and fund additional loans. Additionally, the Bank has secured credit availability of \$5,000,000 with a correspondent bank for short-term liquidity needs, if necessary. This facility must be collateralized by specific securities at the time of any usage. At December 31, 2014, there were no borrowings outstanding, and securities pledged under this credit facility had an amortized cost and fair value of **\$16,885** and **\$19,444**, respectively. At December 31, 2013 there were no borrowings outstanding, and securities pledged under this credit facility had an amortized cost and fair value of \$18,480 and \$21,575.

### Note 9. Profit Sharing Plan

The Bank has a defined contribution 401(k) profit sharing plan covering substantially all full-time employees. Under the 401(k) provision the Bank is currently matching 50% of employee contributions of up to 6% of their compensation as defined under the plan. Additional employer contributions are at the discretion of the Board of Directors. The Bank's contributions to this plan totaled **\$96,872**, \$92,152, and \$92,472, for the years ended December 31, 2014, 2013, and 2012, respectively.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 10. Lease Commitment

The Bank has a branch facility lease for its Seaford, Delaware branch through December 31, 2018. The Bank also has a fifteen-year land lease for its Rehoboth, Delaware branch, with (5) five-year renewal options for a total of twenty-five years, which began in 2000. In 2008 the Bank entered into a six-year lease agreement for its Ocean City branch with a five-year renewal option, for a total of 11 years. In February 2014 this renewal option was exercised. Rent expense under these arrangements was **\$181,479**, \$176,510, and \$186,170 for the years ended December 31, 2014, 2013, and 2012, respectively.

Minimum lease payments for the next five years, assuming renewal options are exercised, are approximately as follows:

2015	\$	182,454
2016		187,667
2017		189,390
2018		191,164
2019		142,085

### Note 11. Other Operating Expenses

Other operating expenses include the following:

	2014		2013		2012
Professional services	\$ 258,082	\$	231,317	\$	200,966
Stationery, printing and supplies	141,552		153,074		136,191
Postage and delivery	146,841		155,055		174,532
FDIC assessment	656,946		966,451		866,121
State bank assessment	1,000		3,023		4,552
Directors fees and expenses	194,200		216,275		251,550
Marketing	198,460		190,086		175,641
Correspondent bank services	75,851		75,545		77,255
ATM expenses	552,748		515,962		495,347
Telephones and mobile devices	92,124		175,497		172,923
Membership dues and fees	52,457		55,757		48,372
Legal fees	296,718		541,543		361,914
Audit fees	116,621		166,027		115,239
Insurance	131,555		141,360		74,481
Other	1,898,944		1,948,115		1,621,007
	\$ 4,814,099	\$	5,535,087	\$	4,776,091

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 12. Stock Option Plans

The Bank has employee and director stock option plans and has reserved **184,440** shares of stock for issuance thereunder. Options granted under these plans have a ten-year life with a four-year vesting period that begins one year after date of grant, and are exercisable at a price equal to the fair value of the Company's stock on the date of the grant. Each award from all plans is evidenced by an award agreement that specifies the option price, the duration of the option, the number of shares to which the option pertains, and such other provisions as the grantor determines. The plan term ended in 2014, therefore no new options can be granted.

Options for 184,440 shares are outstanding as follows:

	Employees			Directors		
	Shares	Average Price	Amount	Shares	Average Price	Amount
December 31, 2011	274,520	\$ 10.32	\$ 2,833,914	100,051	\$ 12.92	\$ 1,292,172
Granted in 2012 and expiring in 2022	5,000	1.98	9,900	-	-	-
Forfeited in 2012	(70,991)	13.21	(937,791)	(23,497)	13.54	(318,148)
December 31, 2012	208,529	9.14	1,906,023	76,554	12.72	974,024
Forfeited in 2013	(32,503)	14.43	(469,018)	(21,338)	14.77	(315,162)
December 31, 2013	176,026	8.16	1,437,005	55,216	11.93	658,860
<b>Forfeited in 2014</b>	<b>(35,314)</b>	<b>15.71</b>	<b>(554,783)</b>	<b>(11,488)</b>	<b>10.78</b>	<b>(123,840)</b>
<b>December 31, 2014</b>	<b>140,712</b>	<b>\$ 6.27</b>	<b>\$ 882,222</b>	<b>43,728</b>	<b>\$ 12.24</b>	<b>\$ 535,020</b>

No stock options were exercised in 2012, 2013 or 2014. Shares issued in connection with stock option exercises are issued from available authorized shares.

As stated in Note 1, the Company adopted the provisions of ASC Topic 718-10 in January 1, 2006. ASC Topic 718-10 requires that stock-based compensation to employees and directors be recognized as compensation cost in the income statement based on their fair values on the measurement date, which, for the Company, is the date of the grant. As a result of applying the provisions of ASC Topic 718-10 during 2014 and 2013, the Company recognized additional stock-based compensation expense of **\$555** and \$5,624, respectively. Stock-based compensation expense for 2014 relates to 2012 stock options. Stock-based compensation expense for 2013 relates to the 2009 stock options of \$5,069, or \$4,465 net of tax and 2012 stock options of \$555. Unrecognized stock-based compensation expense related to stock options totaled approximately **\$600** and \$1,000 at December 31, 2014 and 2013, respectively. The remaining period over which this unrecognized expense was expected to be recognized was one year for 2012 options. The 2009 options expense was fully recognized in 2013.

The weighted average fair value of options granted in 2012 and 2009 had been estimated using the Black-Scholes option pricing model with the following assumptions:

	2012	2011	2010	2009
Dividend yield	-	N/A	N/A	1.34
Risk-free interest rate	<b>2.50</b>	N/A	N/A	3.75 %
Expected volatility	<b>48.69</b>	N/A	N/A	23.16 %
Expected life in years	<b>10</b>	N/A	N/A	10

There were no options granted in 2014, 2013, 2011 or 2010.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 13. Restricted Stock Plan

The Bank has an employee and director reserved stock plan and has reserved **405,805** shares of stock for issuance thereunder. The Company has adopted the Plan, pursuant to which employee and directors of the Company may acquire shares of common stock. The Plan was adopted by the Company's Board of Directors in April 2014, and, subject to the right of the Board of Directors to terminate the Plan at any time, terminates on June 30, 2018. The termination of the Plan, either at the scheduled termination date or before such date, will not affect any award issued prior to termination. Shares awarded in 2014 have a four-year vesting period. The number of shares that will vest is based on the Company's performance relative to pre-established performance goals during the four year vesting period. During 2014 304,472 shares of stock were awarded under the restricted stock plan. Each award from the plan is evidenced by an award agreement that specifies the vesting period of the restricted stock plan, the number of shares to which the award pertains, and such other provisions as the grantor determines.

As of December 31, 2014 non-vested restricted stock awards totaling 255,354 were outstanding as follows:

	Employees		Directors	
	Shares	Weighted Average Fair Value	Shares	Weighted Average Fair Value
Nonvested Awards December 31, 2013	-	\$ -	-	\$ -
<b>Granted in 2014</b>	<b>275,932</b>	<b>4.00</b>	<b>64,540</b>	<b>4.00</b>
<b>Vested in 2014</b>	<b>(55,186)</b>	<b>4.00</b>	<b>(12,908)</b>	<b>4.00</b>
<b>Forfeited in 2014</b>	<b>(13,797)</b>	<b>4.00</b>	<b>(3,227)</b>	<b>4.00</b>
<b>Nonvested Awards December 31, 2014</b>	<b>206,949</b>	<b>\$ 4.00</b>	<b>48,405</b>	<b>\$ 4.00</b>

As stated in Note 1, the Company adopted the provisions of ASC Topic 718-10 in January 1, 2006. ASC Topic 718-10 requires that restricted stock-based compensation to employees and directors be recognized as compensation cost in the income statement based on their fair values on the measurement date. The fair value of restricted stock granted in 2014 is equal to the underlying fair value of the stock. As a result of applying the provisions of ASC Topic 718-10 during 2014, the Company recognized restricted stock-based compensation expense of **\$272,378** or **\$164,925** net of tax related to the 2014 restricted stock awards. Unrecognized restricted stock-based compensation expense related to 2014 restricted stock awards totaled approximately **\$817,000** at December 31, 2014. The remaining period over which this unrecognized expense is expected to be recognized is three years.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 14. Earnings (Loss) Per Share

Diluted earnings (loss) per share are calculated as follows:

	2014	2013	2012
Net income (loss)	\$ 3,509,083	\$ (5,561,272)	\$ 896,247
Less: Preferred stock dividends declared and/or accumulated and warrant accretion	871,625	631,125	703,125
Net income (loss) applicable to basic earnings (loss) per common share	\$ 2,637,458	\$ (6,192,397)	\$ 193,122
Weighted average shares outstanding	8,116,066	5,409,217	4,866,066
Basic earnings (loss) per share	0.325	(1.145)	0.040
Effect of dilutive securities:			
Weighted average shares outstanding under options (1)	225,234	262,965	324,534
Weighted average exercise price	\$ 7.68	\$ 9.06	\$ 10.10
Assumed proceeds on exercise	\$ 1,729,797	\$ 2,382,463	\$ 3,277,793
Average market value	\$ 4.25	\$ 3.62	\$ 2.02
Weighted average shares outstanding under restricted stock plans (2)	249,011	-	-
Diluted weighted average shares and common stock equivalents	8,365,077	-	-
Diluted earnings (loss) per share	\$ 0.315	\$ (1.145)	\$ 0.040

- (1) Options were excluded from the calculation of dilutive earnings per share because they are anti-dilutive.  
(2) Includes vested shares not yet issued and nonvested shares as of December 31, 2014.

### Note 15. Regulatory Capital Requirements

The Company and the Bank are subject to various regulatory capital requirements administered by Federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital adequacy guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weighting, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (as defined in the regulations) of total and Tier I capital to risk-weighted assets, and of Tier I capital to average assets. Management believes as of December 31, 2014 that the Company and the Bank meet all capital adequacy requirements to which they are subject.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 15. Regulatory Capital Requirements (Continued)

As of December 31, 2014, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios. There are no conditions or events since that notification that management believes have changed the Bank's category.

A comparison of the Company's and the Bank's capital amounts and ratios as of December 31, 2014 and 2013 with the minimum requirements are presented below.

						To Be Well Capitalized Under Prompt Corrective Action Provisions						
		<u>Actual</u>				<u>For Capital Adequacy Purposes</u>						
		Amount	Ratio			Amount	Ratio	Amount	Ratio			
<b>As of December 31, 2014</b>												
<b>Total Capital</b>												
(To Risk Weighted Assets)												
Delmar Bancorp	\$	47,522,000	13.08	%	\$	29,065,443	8.00	%	\$	-	N/A	%
The Bank of Delmarva		47,042,000	12.96	%		29,038,272	8.00	%		36,297,840	10.00	%
<b>Tier I Capital</b>												
(To Risk Weighted Assets)												
Delmar Bancorp		43,056,000	11.85	%		14,533,671	4.00	%		-	N/A	%
The Bank of Delmarva		42,578,000	11.73	%		14,519,352	4.00	%		21,779,028	6.00	%
<b>Tier I Capital</b>												
(To Average Assets)												
Delmar Bancorp		43,056,000	9.71	%		17,736,766	4.00	%		-	N/A	%
The Bank of Delmarva		42,578,000	9.60	%		17,740,833	4.00	%		22,176,042	5.00	%
<b>As of December 31, 2013</b>												
<b>Total Capital</b>												
(To Risk Weighted Assets)												
Delmar Bancorp	\$	39,039,000	11.74	%	\$	26,602,000	8.00	%	\$	-	N/A	%
The Bank of Delmarva		38,700,000	11.64	%		26,598,000	8.00	%		33,247,000	10.00	%
<b>Tier I Capital</b>												
(To Risk Weighted Assets)												
Delmar Bancorp		34,828,000	10.47	%		13,306,000	4.00	%		-	N/A	%
The Bank of Delmarva		34,490,000	10.37	%		13,304,000	4.00	%		19,956,000	6.00	%
<b>Tier I Capital</b>												
(To Average Assets)												
Delmar Bancorp		34,828,000	8.41	%		16,565,000	4.00	%		-	N/A	%
The Bank of Delmarva		34,490,000	8.33	%		16,562,000	4.00	%		20,702,000	5.00	%

According to FDIC capital guidelines, the Bank is considered to be "Well Capitalized."

Banking regulations also limit the amount of dividends that may be paid without prior approval of the Bank's regulatory agencies. Regulatory approval is required to pay dividends, which exceed the Bank's net profits for the current year plus its retained net profits for the preceding two years. Due to the enactment of the agreement with the FDIC, payment of any dividend has been restricted unless approved

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 16. Fair Values of Financial Instruments

The following table shows the estimated fair value and the related carrying values of the Company's financial instruments at December 31, 2014 and 2013. Items that are not financial instruments are not included. Amounts are shown in thousands (000).

	2014		2013	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and due from banks	\$ 14,125	\$ 14,125	\$ 16,697	\$ 16,697
Certificates of deposit	100	100	100	100
Federal funds sold	1,385	1,385	1,150	1,150
Securities:				
Available for sale	33,747	33,747	37,648	37,648
Loans, net of allowance for credit losses	378,067	378,786	338,028	337,769
Intangible assets	39	39	90	90
Accrued interest receivable	1,301	1,301	1,173	1,173
Federal Home Loan Bank stock	1,342	1,342	1,371	1,371
Maryland Financial Bank stock	30	30	30	30
Atlantic Central Bankers stock	75	75	75	75
Other investments	1,000	1,000	1,000	1,000
Financial liabilities:				
Deposits	\$ 380,731	\$ 358,468	\$ 355,175	\$ 332,587
Accrued interest payable	196	196	204	204
Short-term borrowings	6,500	6,500	4,000	4,000
Long-term borrowings	15,000	16,142	15,000	15,262
Unrecognized financial instruments:				
Commitments to extend credit	\$ 54,480	\$ 54,480	\$ 51,340	\$ 51,340
Standby letters of credit	4,622	4,622	4,655	4,655

For purposes of the above disclosures of estimated fair value, the following assumptions were used.

#### Loans:

The estimated fair value for certain homogeneous categories of loans, such as residential mortgages, is based on the quoted market price for securities backed by similar loans, adjusted for differences in loan characteristics. The estimated fair value of other loans is determined by discounting future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

#### Investment securities:

Estimated fair values are based on quoted market prices for actual or similar instruments or estimated using discounted cash flows. The discounts used are estimated using comparable market rates for similar types of instruments adjusted to be commensurate with the audit risk, overhead costs, and optionality of such investments.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 16. Fair Values of Financial Instruments (Continued)

#### Deposits:

The estimated fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings, NOW accounts and money market accounts, is equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The fair value of certificates of deposit is based on the rates currently offered for deposits of similar maturities and using a discounted cash flow analysis. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

#### Borrowings:

The estimated fair value approximates carrying value for short-term borrowings. The fair value of long-term fixed rate borrowings is estimated by discounting future cash flows using current interest rates currently offered for similar financial instruments.

#### Other assets and liabilities:

The estimated fair value for cash and due from banks, interest-bearing deposits in other banks, and Federal funds purchased is considered to approximate cost because of their short-term nature.

Other assets and liabilities of the Bank that are not defined as financial instruments are not included in the above disclosures, such as property and equipment. Also, non-financial instruments typically not recognized in the financial statements nevertheless may have value but are not included in the above disclosures. These include, among other items, the estimated earnings power of core deposit accounts, the trained work force, customer goodwill, and similar items.

### Note 17. Fair Value Measurements

Effective January 1, 2008, the Company adopted ASC 820-10 Fair Value Measurements and Disclosures which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. ASC Topic 820 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available-for-sale investments securities) or on a nonrecurring basis (for example, impaired loans).

ASC Topic 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC Topic 820 also 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.

#### *Fair Value Hierarchy*

Level 1 – Quoted prices in active markets for identical assets or liabilities

Level 2 – Other significant observable inputs (including quoted prices in active markets for similar assets or liabilities)

Level 3 – Significant unobservable inputs (including the Bank's own assumptions in determining the fair value of assets or liabilities)

In determining the appropriate levels, the Bank performs a detailed analysis of assets and liabilities that are subject to ASC Topic 820.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 17. Fair Value Measurements (Continued)

The following table presents fair value measurements on a recurring basis as of December 31, 2014:

	Level 1	Level 2	Level 3	Fair Value
Securities available for sale:				
Obligations of U.S				
Government agencies	\$	-	\$ 8,273,087	\$ -
Obligations of States and political subdivisions		11,532,861		11,532,861
Mortgage-backed securities		12,979,193		12,979,193
Equity securities		961,655		961,655
Total securities available for sale		33,746,796		33,746,796
Other investments		1,000,000		1,000,000
<b>Total</b>	<b>\$</b>	<b>-</b>	<b>\$ 34,746,796</b>	<b>\$ -</b>

Securities available-for-sale are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments, which are considered level 2 inputs. For these securities, management obtains fair value measurements from an independent pricing service.

The Bank may also be required, from time to time, to measure certain other financial and non-financial assets and liabilities at fair value on a non-recurring basis in accordance with GAAP. The following table presents all fair value measurements on a non-recurring basis as of December 31, 2014:

	Level 1	Level 2	Level 3	Value
Impaired loans	\$	-	\$ 21,288,778	\$ 21,288,778
OREO		3,722,569		3,722,569
Core deposit intangible			38,578	38,578
Restricted securities - MFB			30,000	30,000
<b>Total</b>	<b>\$</b>	<b>-</b>	<b>\$ 3,722,569</b>	<b>\$ 21,357,356</b>

Measured on a Non-Recurring Basis:

#### Financial Assets and Liabilities

The Bank is predominantly a cash flow lender with real estate serving as collateral on a majority of loans. Loans which are deemed to be impaired financial assets are primarily valued on a nonrecurring basis at the fair values of the underlying real estate collateral. The Bank determines such fair values from independent appraisals, which management considers level 3 inputs. In addition, the Maryland Financial Bank stock was written down by \$70,000 to a value of \$30,000 in 2011 due to the price of a new stock offering, which was discounted to par, which management considers level 3 inputs.

#### Non Financial Assets and Non Financial Liabilities

Application of ASC Topic 820 to non-financial assets and non-financial liabilities became effective January 1, 2009. The Corporation has no non-financial assets and non-financial liabilities measured at fair value on a recurring basis. Certain non-financial assets and non-financial liabilities typically measured at fair value on a non-recurring basis include foreclosed assets (upon initial recognition or subsequent impairment), non-financial assets and non-financial liabilities measured at fair value in the second step of a goodwill impairment test, and intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 17. Fair Value Measurements (Continued)

Foreclosed real estate were adjusted to their fair values, resulting in an impairment charge, which was included in earnings for the year. Foreclosed real estate, which are considered to be non-financial assets, have been valued using a market approach at the time they are recorded in OREO. The values were determined using current market prices of similar real estate assets, which the Bank considers to be level 2 inputs.

The Bank employs general industry practices in evaluating the fair value of its core deposit intangibles, but primarily relies on market multiples (pricing ratios) under the market approach to establish values using level 3 inputs.

### Note 18. Business Asset Acquisition

In September 2008, the Bank acquired the deposit accounts and certain assets and liabilities of a local competitor bank located in Ocean City, Maryland for a deposit premium of 3.7% of total deposit balances. The Bank took over full operations of this location, under an already existing lease. The premium paid on deposits exceeded the fair value of assets received by \$421,248, which is recognized as an intangible asset. The bank will record approximately \$60,000 in amortization expense per year over a seven year period until fully amortized. There is a balance of \$38,578 remaining to be amortized.

### Note 19. Troubled Asset Relief Program/Preferred Stock

On December 4, 2009, Delmar Bancorp participated in the United States Department of the Treasury ("Treasury") Troubled Asset Relief Program ("TARP") Capital Purchase Program by issuing 9,000 shares of Fixed Rate Cumulative Perpetual Preferred, Series A ("Series A") and 450 shares of Fixed Rate Cumulative Perpetual Preferred, Series B ("Series B") to the treasury for a total sales price of \$9,000,000.

The Fixed Rate Cumulative Perpetual Preferred, Series B Preferred Stock was part of a cashless exercise of a warrant that took place on December 4, 2009. The Warrant was recorded at its liquidation amount of \$1,000 per share and is considered to be an imputed dividend that will be amortized over five years.

The agreement with Treasury contains limitations on certain actions of Delmar Bancorp, including the payment of quarterly cash dividends on Delmar Bancorp's common stock in excess of \$0.056 per share and the repurchase of its common stock during the first three years of the agreement. Delmar Bancorp also agreed that, while Treasury owns the Preferred Stock, Delmar Bancorp and its subsidiaries' employee benefit plans and other executive compensation arrangements for its senior executive officers must comply with Section 111(b) of the Emergency Economic Stabilization Act of 2008.

Cumulative dividends on the Series A Preferred Stock are payable at 5% per annum for the first five years and at a rate of 9% per annum thereafter. Cumulative dividends on the Series B Preferred Stock are payable at 9% per annum. The shares of Series A and Series B Preferred Stock have no stated maturity, do not have voting rights except in limited circumstances and are not subject to mandatory redemption or a sinking fund. The Series A and Series B Preferred Stock have priority over Delmar Bancorp common stock with regard to the payment of dividends and liquidation distribution.

So long as any share of the Series A or Series B Preferred Stock remains outstanding, no dividend or distribution may be declared or paid on Common Stock and no Common Stock may be, directly or indirectly, purchased, redeemed or otherwise acquired for consideration by the Company or any of its subsidiaries unless all accrued and unpaid dividends for all past dividend periods, including the latest completed dividend period on all outstanding Series A and Series B Preferred Stock have been or are contemporaneously declared and paid in full (or have been declared and a sum sufficient for the payment thereof has been set aside for the benefit of the holders of the Series A and Series B Preferred Stock on the applicable record date).

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 19. Troubled Asset Relief Program/Preferred Stock (Continued)

Under the terms of the Preferred Stock whenever, dividends payable on the shares of the Series A and Series B Preferred Stock have not been paid for an aggregate of six quarterly dividend periods or more, whether or not consecutive, the holders of the Series A and Series B Preferred Stock, voting as a single class, shall have the right to elect two directors until such time as dividends are paid in full. As of December 31, 2014, the Company had deferred thirteen payments of its regular quarterly cash dividends with respect to the Series A and Series B Preferred Stock. The total amount of accumulated dividends was \$781,625 as of December 31, 2014. On February 15, 2015, the Company deferred a fourteenth payment of its regular quarterly cash dividend with respect to the Series A and Series B Preferred Stock.

No dividends were paid on the Series A and Series B Preferred Stock during 2014, 2013 or 2012. Dividends in arrears totaled \$781,625, \$541,125 and \$613,125, as of December 31, 2014, 2013 and 2012, respectively. Interest on the dividends in arrears totaled approximately \$89,000, \$40,000 and \$13,000 for 2014, 2013 and 2012, respectively. During 2014, 2013 and 2012 the Company recorded \$90,000 of accretion associated with the Series B Preferred Stock.

On January 29, 2013, Treasury auctioned the Company's outstanding Series A and Series B Preferred Stock to private parties as part of its strategy to wind down its remaining TARP bank investments. Effective February 7, 2013, the Company was no longer a participant in Treasury's Troubled Asset Relief Program and was no longer subject to the compensation and benefit limitations and restrictions under the TARP program.

During 2013 the Company entered into an agreement with a holder of TARP preferred pursuant to which the holder acquired 3,250,000 newly issued shares of the Company's common stock for aggregate consideration consisting of \$6,000,000 in cash, the cancellation of the holder's 5,000 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A, having an aggregate liquidation amount of \$5,000,000, and the waiver of unpaid dividends on the Series A Preferred Stock and interest on unpaid dividends, in an amount equal to approximately \$600,000 at closing. The transaction closed on November 1, 2013 and resulted in an increase of \$11,000,000 in the Company's common stockholders' equity, and a reduction of \$5,000,000 in the preferred stock account. The new capital was down-streamed to the Bank as a capital infusion.

### Note 20. Enforcement Action

On April 20, 2012 the Board of Directors of the Bank entered into a Consent Order (the "Order") with the Federal Deposit Insurance Corporation ("FDIC"). The Bank entered into the Order without admitting or denying any charges of unsafe or unsound banking practices or violations of law or regulation. The Order covered areas of the Bank's operations that warranted improvement and various requirements in making those improvements. The Order was terminated May 28, 2014 and replaced with a Memorandum of Understanding (the "MOU") which addresses certain of the matters covered by the Order with similar requirements. The MOU will remain in effect and is enforceable until it is modified, terminated, suspended, or set aside by the FDIC.

While the Order is in effect, the Bank is not permitted to declare or pay any dividend without the prior written consent of the FDIC.

The Bank is required to furnish written quarterly progress reports to the FDIC detailing the form, manner, and results of any actions taken to secure compliance. All quarterly progress reports have been filed timely with the FDIC. The Bank has addressed all requirements of the MOU.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### **Note 20. Enforcement Action (Continued)**

On June 12, 2012 the Board of Directors of the Company entered into a Written Agreement (the "Agreement") with the Federal Reserve Bank of Richmond ("FRB"). The Company entered into the Agreement without admitting or denying any charges of unsafe or unsound banking practices or violations of law or regulation. The Agreement requires the Board of Directors to take appropriate steps to fully utilize the Company's financial and managerial resources to serve as a source of strength to the Bank. The Agreement was terminated by the FRB August 22, 2014 and replaced with a Memorandum of Understanding (the "FRB MOU") which contained substantially similar requirements as the Agreement. The FRB MOU will remain in effect and is enforceable until it is modified, terminated, suspended, or set aside by the FRB.

While the FRB MOU is in effect, the Company may not declare or pay any dividends without the prior written approval of the FRB or directly or indirectly take dividends or any other form of payment representing a reduction in capital from the Bank without the prior written approval of the Bank's Federal or State regulator.

The Company may not, directly or indirectly, incur, increase, or guarantee any debt without the prior written approval of the FRB. The Company may not, directly or indirectly, purchase or redeem any shares of its stock without the prior written approval of the FRB.

The Company is required to furnish quarterly written progress reports to the FRB detailing the form, manner, and results of any actions taken to secure compliance. All quarterly progress reports have been filed timely with the FRB. The Company has addressed all requirements of the FRB MOU.

### **Note 21. Sale of Subsidiary**

During the year ended December 31, 2011, the Company entered into a contract to sell the primary assets of one of its subsidiaries, Hanna, Kremer & Tilghman Insurance Agency, Inc. The sale occurred in October 2011 resulting in a gain of \$645,000 to the consolidated entity, which was later adjusted in 2014 in accordance with the sales agreement for an additional gain of \$46,620.

### **Note 22. Date of Management's Review**

In preparing the financial statements, management has evaluated events and transactions for potential recognition or disclosure through February 26, 2015, the date that the financial statements were available to be issued.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 23. Parent Company Financial Information

Presented below are comparative balance sheets of the parent company, Delmar Bancorp, as of December 31, 2014 and 2013, and statements of operations and cash flows for each of the years ended December 31, 2014, 2013 and 2012.

#### BALANCE SHEETS December 31, 2014 and 2013

	2014	2013
<b>ASSETS</b>		
Cash	\$ 304,863	\$ 379,021
Investment in subsidiaries, at equity	44,635,271	40,526,416
Other assets	181,205	59,504
<b>Total assets</b>	<b>\$ 45,121,339</b>	<b>\$ 40,964,941</b>
<b>LIABILITIES</b>		
Deferred gain	\$ -	\$ 100,000
Other liabilities	7,904	552
<b>Total liabilities</b>	<b>\$ 7,904</b>	<b>\$ 100,552</b>
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, par value \$.01 per share, authorized 9,990,550 shares; issued and issued and outstanding 2014 and 2013 8,116,066	\$ 81,161	\$ 81,161
Preferred Stock, Series A and B (See Note 19)	4,450,000	4,450,000
Surplus	16,488,679	16,125,746
Retained earnings	23,848,738	20,429,655
Accumulated other comprehensive income (loss), net of deferred (tax) benefits 2014 (\$159,598); 2013 \$144,620	244,857	(222,173)
<b>Total stockholders' equity</b>	<b>45,113,435</b>	<b>40,864,389</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 45,121,339</b>	<b>\$ 40,964,941</b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 23. Parent Company Financial Information (Continued)

#### STATEMENTS OF OPERATIONS Years Ended December 31, 2014, 2013, and 2012

	2014	2013	2012
Stock-based compensation expense	\$ (272,933)	\$ (5,624)	\$ (15,943)
Other expenses (net)	23,250	(39,941)	(46,850)
Loss before income taxes and equity in undistributed net loss of subsidiaries	(249,683)	(45,565)	(62,793)
Income tax benefits (1)	116,941	8,269	10,987
Equity in undistributed net income (loss) of subsidiaries	3,641,825	(5,523,976)	948,053
Net income (loss)	\$ 3,509,083	\$ (5,561,272)	\$ 896,247

(1) Benefits from filing consolidated Federal income tax return.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 23. Parent Company Financial Information (Continued)

Years Ended December 31, 2014, 2013, and 2012

	2014	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income (loss)	\$ 3,509,083	\$ (5,561,272)	\$ 896,247
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:			
Equity in undistributed net (income) loss of subsidiaries	(3,641,825)	5,523,976	(948,053)
Stock-based compensation expense	272,933	5,624	15,943
Changes in assets and liabilities:			
(Increase) decrease in deferred gain and other liabilities	(92,648)	100,552	-
Increase in other assets	(121,701)	(1,405)	(2,094)
Net cash (used in) provided by operating activities	(74,158)	67,475	(37,957)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Payments for investments in subsidiary	-	(6,000,000)	-
Proceeds from liquidation of subsidiary	-	279,214	-
Net cash used by investing activities	-	(5,720,786)	-
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from Eastern Shore Insurance Holdings, Inc.	-	20,000	35,000
Proceeds from stock issuance	-	6,000,000	-
Net cash provided by financing activities	-	6,020,000	35,000
Net (decrease) increase in cash	(74,158)	366,689	(2,957)
<b>Cash, beginning of year</b>	<b>379,021</b>	<b>12,332</b>	<b>15,289</b>
<b>Cash, end of year</b>	<b>\$ 304,863</b>	<b>\$ 379,021</b>	<b>\$ 12,332</b>

**DELMAR BANCORP  
and  
THE BANK OF DELMARVA  
DIRECTORS**

***Heidi J.A. Gilmore, Esquire***

*Baird, Mandalas Brockstedt, LLC  
Partner*

***Paul H. Mylander***

*Delaware National Bank  
Retired President and CEO*

***Mark L. Granger***

*Granger & Company, P.A.  
President*

***Edward M. Thomas***

*The Bank of Delmarva and Delmar Bancorp  
President and Chief Executive Officer*

***Henry H. Hanna, III, CCIM, SIOR***

*Sperry Van Ness  
Miller Commercial Real Estate  
Senior Advisor*

***Jeffrey F. Turner***

*Mercantile Peninsula Bank  
Retired President and CEO  
Chairman of the Board*

***Wade H. Insley, III***

*Cullen, Insley & Benson, LLP  
Partner*

***Robert C. Wheatley***

*Alliance Real Estate Professionals  
Partner*

***Kenneth R. Lehman***

*Retired Attorney  
Private Investor*

***J. Phillips Wright, Jr.***

*Vernon Powell Shoe Company Chairman  
SAS Shore Footwear, Inc. President*

---

***Francis M. Young  
Director Emeritus***

*Salisbury Brick Company, Inc.  
Retired President*

**THE BANK OF DELMARVA**  
**DIRECTORS AND COMMITTEE MEMBERS**

**HEIDI J.A. GILMORE, ESQUIRE**

Loan Committee

**MARK L. GRANGER**

Audit Committee

Loan Committee, Chairman

**HENRY H. HANNA, III, CCIM, SIOR**

Loan Committee

**WADE H. INSLEY, III**

Audit Committee, Chairman

Governance Committee

Loan Committee

**KENNETH R. LEHMAN**

**PAUL H. MYLANDER**

Governance Committee

Loan Committee

**EDWARD M. THOMAS**

Governance Committee

Loan Committee

Regulatory Compliance Committee

**JEFFREY F. TURNER, Chairman of the Board**

Audit Committee

Governance Committee

Loan Committee

**ROBERT C. WHEATLEY**

Loan Committee

Regulatory Compliance Committee, Chairman

**J. PHILLIPS WRIGHT, JR.**

Audit Committee

Governance Committee, Chairman



# **Delmarva** *Investment Services*

## **John Bennish**

Assistant Vice President - Delmarva Investment Services  
Investment Executive - Infinex

**2245 Northwood Drive  
Salisbury, MD 21801**

**410-548-2623 - 866-440-2623**

**[jbennish@infinexgroup.com](mailto:jbennish@infinexgroup.com)**

Securities offered through INFINEX INVESTMENTS, INC. Member FINRA/SIPC. Delmarva Investment Services is a trade name of the bank. Infinex and the bank are not affiliated.

- Not a deposit
- Not FDIC - Insured

- Not insured by any Federal Government Agency

- Not guaranteed by the bank
- May go down in value

## DELMAR BANCORP OFFICERS

### ***Chairman of the Board***

Jeffrey F. Turner

### ***President and Chief Executive Officer***

Edward M. Thomas

### ***Vice President and Secretary***

Kimberly T. Thomas, CPA

### ***Treasurer***

Angela A. Hill

## THE BANK OF DELMARVA OFFICERS

### ***President and Chief Executive Officer***

Edward M. Thomas

### ***Internal Auditor***

Charles S. Gallo

### ***Executive Vice President and Chief Credit Officer***

John W. Breda

### ***Assistant Vice President***

Carol J. Adams

John Q. Aukward, Jr.

June E. Betts

Kevin J. Christophel

Karin A. D'Armi Hunt

Marcia L. Dayton

Sarah "Salli" Goodrich

Crystal L. Hudson

Alesia Lukashova

Robin H. Parker

Scott J. Rukowicz

Nancy L. Shrieves

Amy L. Townsend

Karen M. Turner

Jon W. Ulrich

Christine R. Watts

### ***Senior Vice President***

Deborah S. Abbott

Carl L. Cottingham

Lawrence L. Dernulc

### ***Vice President***

John A. Craig

Lisa L. Ellis

Joseph F. Gordy, III

Angela A. Hill

Roy J. Lewis

Sandy L. Nailor

Staci M. Niblett

S. Jeanne Robertson

Matthew P. Shaffer

Jeanette S. Smith

Michele U. Thomas

Paige Widdowson

### ***Investment Executive***

John Bennish

### ***Assistant Cashier***

Matthew E. Bounds

Jodi L. Close

**Services**

ATM/Debit Card  
Auto-Draft (transfer from one account to another)  
Direct Deposit - Night Depository - Safe Deposit Boxes  
Money Orders - Travelers Checks  
TeleBANC  
Internet Home Banking  
Internet Bill Payment  
Consumer Mobile Banking and Mobile Deposit  
Online Statements  
Cash Management/Remote Deposit Capture  
Customer Service – 800-787-4542/410-548-7892

**Deposits**

Certificates of Deposit - Christmas Club Savings  
IRA - Tiered Money Market - NOW  
Personal and Business Checking - Savings

**Loans**

Automobile - Boat - Commercial - Equipment  
Commercial Lines of Credit - Home Equity - Home Improvement  
Mortgage - Personal - Personal Lines of Credit (Key Line)  
SBA and USDA Guaranteed

**TeleBANC**

410-742-0411 or 866-991-2262

Delmar Bancorp's quarterly Consolidated Financial Statements for Holding Companies, FR Y-9C, can be viewed by visiting [www.bankofdelmarvahb.com/home/about/investorrelations](http://www.bankofdelmarvahb.com/home/about/investorrelations) or [www.ffiec.gov/nicpubweb/nicweb/searchform.aspx](http://www.ffiec.gov/nicpubweb/nicweb/searchform.aspx) and searching "Delmar Bancorp".

**Visit us online @  
[www.bankofdelmarva.com](http://www.bankofdelmarva.com)**

## THE BANK OF DELMARVA

### BRANCH OFFICES

#### ***Delmar Office***

**Kevin J. Christophel, Manager**

(410)896-9041

9550 Ocean Highway

Delmar, Maryland 21875

#### ***North Salisbury Office***

**Lisa L. Ellis, Manager**

(410)742-9401

2727 North Salisbury Boulevard

Salisbury, Maryland 21801

#### ***East Salisbury Office***

**Nancy L. Shrieves, Manager**

(410)543-9300

241 Beaglin Park Drive

Salisbury, Maryland 21804

#### ***Eastern Shore Drive Office***

**John Q. Aukward, Jr., Manager**

(410)548-1700

921 Eastern Shore Drive

Salisbury, Maryland 21801

#### ***Pecan Square Office***

**Marcia L. Dayton, Manager**

(410)546-2100

1206 Nanticoke Road

Salisbury, Maryland 21801

#### ***Cash Mgt./Remote Deposit Capture***

**Karin D'Armi - Hunt**

(410)548-1100

2245 Northwood Drive

Salisbury, Maryland 21801

#### ***Seaford Office***

**Robin H. Parker, Manager**

(302)629-2700

910 Norman Eskridge Highway

Seaford, Delaware 19973

#### ***Laurel Office***

**Sarah "Salli" Goodrich, Manager**

(302)875-5901

200 East Market Street

Laurel, Delaware 19956

#### ***Dagsboro Office***

**Crystal L. Hudson, Manager**

(302)732-3610

28280 Clayton Street, Post Office Box 98

Dagsboro, Delaware 19939

#### ***Pelican Square Office***

**June E. Betts, Manager**

(302)226-8900

18572 Coastal Highway

Rehoboth Beach, Delaware 19971

#### ***Ocean City Office***

**Karen M. Turner, Manager**

(410)250-5330

12505 Coastal Highway

Ocean City, Maryland 21842

#### ***Loan Department***

**Sandy L. Nailor, Manager**

(410)548-1100

2245 Northwood Drive

Salisbury, Maryland 21801

[illegible]