

DNB FINANCIAL CORP /PA/  
Form 10-K  
March 14, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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FORM 10-K

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

For the fiscal year ended

December 31, 2018

or

TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the transition period from                      to                      . Commission file Number 1-34242

(Exact Name of registrant as specified in its charter)

Pennsylvania	23-2222567
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
4 Brandywine Avenue, Downingtown, Pennsylvania	19335
(Address of principal executive offices)	(Zip Code)
Registrant's telephone number, including area code: (610) 269-1040	

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common stock, par value \$1.00 per share	The Nasdaq Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.    Yes    No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.    Yes    No

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provide pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of the shares of common stock of the Registrant issued and outstanding on June 30, 2018, which excludes 504,000 shares held by all directors, officers and affiliates of the Registrant as a group, was approximately \$133.1 million. This figure is based on the closing price of \$35.05 per share of the Registrant's common stock on June 30, 2018, the last business day of the Registrant's second fiscal quarter.

As of March 14, 2019, the Registrant had outstanding 4,327,415 shares of Common Stock, \$1 par value per share.

#### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive Proxy Statement relating to the 2019 Annual Meeting of Shareholders are incorporated by reference into Part III of this Form 10-K.

FORM 10-K

DNB FINANCIAL CORPORATION

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DNB FINANCIAL CORPORATION

FORM 10-K

Forward Looking Statements

This Annual Report on Form 10-K, as well as other written or oral communications made from time to time by us, contains forward-looking information within the meaning of the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. These statements relate to future events or future predictions, including events or predictions relating to future financial performance, and are generally identifiable by the use of forward-looking terminology such as “believe,” “expect,” “may,” “will,” “should,” “plan,” “intend,” or “anticipate” or the negative thereof or comparable terminology. Forward-looking statements reflect numerous assumptions, estimates and forecasts as to future events. No assurance can be given that the assumptions, estimates and forecasts underlying such forward-looking statements will accurately reflect future conditions, or that any guidance, goals, targets or projected results will be realized. The assumptions, estimates and forecasts underlying such forward-looking statements involve judgments with respect to, among other things, future economic, competitive, regulatory and financial market conditions and future business decisions, which may not be realized and which are inherently subject to significant business, economic, competitive and regulatory uncertainties and known and unknown risks, including the risks described under “Risk Factors” in this Annual Report on Form 10-K, as such factors may be updated from time to time in our filings with the SEC, including our Quarterly Reports on Form 10-Q. Our actual results may differ materially from those reflected in the forward-looking statements.

In addition to the risks described in the “Risk Factors” section of this Annual Report on Form 10-K and the other reports we file with the SEC, important factors to consider and evaluate with respect to such forward-looking statements include:

- Changes in external competitive market factors that might impact our results of operations;
- Changes in laws and regulations, including without limitation changes in capital requirements under Basel III;
- The impact of the federal Tax Cuts and Jobs Act of 2017, including, but not limited to, the effect of a lower federal corporate income tax rate, including on the valuation of our tax assets and liabilities;
- Changes in our business strategy or an inability to execute our strategy due to the occurrence of unanticipated events;
- Local, regional and national economic conditions and events, including real estate values, and the impact they may have on us and our customers;

- Costs and effects of regulatory and legal developments, including official and unofficial interpretations by regulatory agencies of laws and regulations, the results of regulatory examinations and the outcome of regulatory or other governmental inquiries and proceedings, such as fines or restrictions on our business activities;
- Our ability to attract deposits and other sources of liquidity;
- Changes in the financial performance and/or condition of our borrowers;
- Our ability to access the capital markets to fund our operations and future growth;
- Changes in the level of non-performing and classified assets and charge-offs;
- Changes in estimates of future loan loss reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements;
- Inflation, interest rate, securities market and monetary fluctuations;
  - Timely development and acceptance of new banking products and services and perceived overall value of these products and services by users;
- Changes in consumer spending, borrowing and saving habits;
- Technological changes;
- Significant disruption in the technology platforms on which we rely, including security failures, cyberattacks or other breaches of our systems or those of our customers, partners or service providers;
- Continued volatility in the credit and equity markets and its effect on the general economy;
- Effects of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters;

- Our ability to identify potential candidates for, and consummate, acquisition or investment transactions;
- The timing of acquisition, investment, or disposition transactions;
- Constraints on our ability to consummate an attractive acquisition or investment transaction because of significant competition for these opportunities;
- The businesses of DNB and any acquisition targets or merger partners and subsidiaries not integrating successfully or such integration being more difficult, time-consuming or costly than expected;
- Material differences in the actual financial results of merger and acquisition activities compared with expectations, such as with respect to the full realization of anticipated cost savings and revenue enhancements within the expected time frame;
- Our ability to successfully implement our growth strategy, increase market share, control expenses and maintain liquidity; and
- DNB First's ability to pay dividends to DNB Financial Corporation.

You are cautioned not to place undue reliance on any forward-looking statements we make, which speak only as of the date they are made. We do not undertake any obligation to release publicly or otherwise provide any revisions to any forward-looking statements we may make, including any forward-looking financial information, to reflect events or circumstances occurring after the date hereof or to reflect the occurrence of unanticipated events, except as may be required under applicable law.

Part I

Item 1. Business

General Description of Registrant's Business and Its Development

DNB Financial Corporation (the "Registrant" or "DNB"), a Pennsylvania business corporation, is a bank holding company registered with and supervised by the Board of Governors of the Federal Reserve System (Federal Reserve Board). The Registrant was incorporated on October 28, 1982 and commenced operations on July 1, 1983 upon consummation of the acquisition of all of the outstanding stock of Downingtown National Bank, now known as DNB First, National Association (the "Bank"). Since commencing operations, DNB's business has consisted primarily of managing and supervising the Bank, and its principal source of income has been derived from the Bank. At December 31, 2018, DNB had total consolidated assets, total liabilities and stockholders' equity of \$1.2 billion, \$1.0 billion, and \$111.8 million, respectively.

The Bank was organized in 1860. The Bank is a national banking association that is a member of the Federal Reserve System, the deposits of which are insured by the Federal Deposit Insurance Corporation ("FDIC"). The Bank is a full service commercial bank providing a wide range of services to individuals and small to medium sized businesses in the southeastern Pennsylvania market area, including accepting time, demand, and savings deposits and making secured and unsecured commercial, real estate and consumer loans. In addition, the Bank has fifteen (15) full service branches and a full-service wealth management group known as "DNB First Wealth Management." The Bank's financial subsidiary, DNB Financial Services, Inc., (also known as "DNB Investments & Insurance") is a Pennsylvania licensed insurance agency, which, through a third party marketing agreement with Cetera Investment Services, LLC, sells a broad variety of insurance and investment products. The Bank's other subsidiaries are Downco, Inc. and DN Acquisition Company, Inc. which were incorporated in December 1995 and December 2008, respectively, for the purpose of acquiring and holding Other Real Estate Owned acquired through foreclosure or deed in-lieu-of foreclosure, as well as Bank-occupied real estate.

The Bank's headquarters is located at 4 Brandywine Avenue, Downingtown, Pennsylvania. As of December 31, 2018, the Bank had total assets of \$1.2 billion, total deposits of \$984.8 million and total stockholders' equity of \$130.0 million. The Bank's business is not seasonal in nature. The FDIC, to the extent provided by law, insures its deposits. On December 31, 2018, the Bank had 156 full-time employees and 18 part-time employees.

The Bank derives its income principally from interest charged on loans and, to a lesser extent, interest earned on investments, fees received in connection with the origination of loans, wealth management and other services. The Bank's principal expenses are interest expense on deposits and borrowings and operating expenses. Funds for activities are provided principally by operating revenues, deposit growth and the repayment of outstanding loans and investments.

The Bank encounters vigorous competition from a number of sources, including other commercial banks, thrift institutions, other financial institutions and financial intermediaries. In addition to commercial banks, Federal and state savings and loan associations, savings banks, credit unions and industrial savings banks actively compete in the Bank's market area to provide a wide variety of banking services. Mortgage banking firms, real estate investment trusts, finance companies, insurance companies, leasing companies and brokerage companies, financial affiliates of industrial companies and certain government agencies provide additional competition for loans and for certain financial services. The Bank also competes for interest bearing funds with a number of other financial intermediaries, which offer a diverse range of investment alternatives, including brokerage firms and mutual fund companies.

DNB's internet website address is [www.dnbfirst.com](http://www.dnbfirst.com). Information on DNB's website is not part of this Annual Report on Form 10-K. Investors can obtain copies of DNB's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or



15(d) of the Securities Exchange Act of 1934, as amended, on DNB's website (accessible under "Investor Relations" – "SEC Filings") as soon as reasonably practicable after DNB has filed such materials with, or furnished them to, the Securities and Exchange Commission ("SEC"). DNB will also furnish a paper copy of such filings free of charge upon request. DNB's filings can also be accessed at the SEC's internet website:  
<https://www.sec.gov/cgi-bin/browse-edgar?CIK=713671>.

#### Supervision and Regulation — Registrant

##### Federal Banking Laws

The Registrant is subject to a number of complex Federal banking laws, most notably the provisions of the Bank Holding Company Act of 1956, as amended ("Bank Holding Company Act") and the Change in Bank Control Act of 1978 ("Change in Control Act"), and to supervision by the Federal Reserve Board.

## Bank Holding Company Act — Financial Holding Companies

The Bank Holding Company Act requires a “company” (including the Registrant) to secure the prior approval of the Federal Reserve Board before it owns or controls, directly or indirectly, more than five percent (5%) of the voting shares or substantially all of the assets of any bank. It also prohibits acquisition by any “company” (including the Registrant) of more than five percent (5%) of the voting shares of, or interest in, or all or substantially all of the assets of, any bank located outside of the state in which a current bank subsidiary is located unless such acquisition is specifically authorized by laws of the state in which such bank is located. A “bank holding company” (including the Registrant) is prohibited from engaging in or acquiring direct or indirect control of more than five percent (5%) of the voting shares of any company engaged in non-banking activities unless the Federal Reserve Board, by order or regulation, has found such activities to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In making this determination, the Federal Reserve Board considers whether the performance of these activities by a bank holding company would offer benefits to the public that outweigh possible adverse effects. Applications under the Bank Holding Company Act and the Change in Control Act are subject to review, based upon the record of compliance of the applicant with the Community Reinvestment Act of 1977 (“CRA”). See further discussion below.

The Registrant is required to file an annual report with the Federal Reserve Board and any additional information that the Federal Reserve Board may require pursuant to the Bank Holding Company Act. The Federal Reserve Board may also make examinations of the Registrant and any or all of its subsidiaries. Further, under Section 106 of the 1970 amendments to the Bank Holding Company Act and the Federal Reserve Board’s regulations, a bank holding company and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit or provision of credit or provision of any property or services. The so-called “anti-tie-in” provisions state generally that a bank may not extend credit, lease, sell property or furnish any service to a customer on the condition that the customer provide additional credit or service to the bank, to its bank holding company or to any other subsidiary of its bank holding company or on the condition that the customer not obtain other credit or service from a competitor of the bank, its bank holding company or any subsidiary of its bank holding company.

**Permitted Non-Banking Activities.** The Federal Reserve Board permits bank holding companies to engage in non-banking activities so closely related to banking or managing or controlling banks as to be a proper incident thereto. A number of activities are authorized by Federal Reserve Board regulation, while other activities require prior Federal Reserve Board approval. The types of permissible activities are subject to change by the Federal Reserve Board. Revisions to the Bank Holding Company Act contained in the Gramm Leach Bliley Act of 1999 permit certain eligible bank holding companies to qualify as “financial holding companies” and thereupon engage in a wider variety of financial services such as securities and insurance activities, and subject such companies to increased competition from a wider variety of non-banking competitors as well as banks.

**Gramm Leach Bliley Act of 1999 (“GLB”).** This law repealed certain restrictions on bank and securities firm affiliations, and allows bank holding companies to elect to be treated as a “financial holding company” that can engage in approved “financial activities,” including insurance, securities underwriting and merchant banking. Banks without holding companies can engage in many of these financial activities through a “financial subsidiary.” The law also mandates functional regulation of bank securities activities. Banks’ exemption from broker-dealer regulation is limited to, for example, trust, safekeeping, custodian, shareholder and employee benefit plans, sweep accounts, private placements (under certain conditions), self-directed IRAs, third party networking arrangements to offer brokerage services to bank customers, and the like. It also requires banks that advise mutual funds to register as investment advisers. The legislation provides for state regulation of insurance, subject to certain specified state preemption standards. It establishes which insurance products banks and bank subsidiaries may provide as principal or underwriter, and prohibits bank underwriting of title insurance, but also preempts state laws interfering with affiliations. GLB prohibits approval of new de novo thrift charter applications by commercial entities and limits sales of existing so-called “unitary” thrifts to commercial entities. The law bars banks, savings and loans, credit unions, securities firms and insurance companies, as well as other “financial institutions,” from disclosing customer account numbers or access codes to

unaffiliated third parties for telemarketing or other direct marketing purposes, and enables customers of financial institutions to “opt out” of having their personal financial information shared with unaffiliated third parties, subject to exceptions related to the processing of customer transactions and joint financial services marketing arrangements with third parties, as long as the institution discloses the activity to its customers and requires the third party to keep the information confidential. It requires policies on privacy and disclosure of information to be disclosed annually, requires federal regulators to adopt comprehensive regulations for ensuring the security and confidentiality of consumers’ personal information, and allows state laws to give consumers greater privacy protections. The GLB has increased the competition the Bank faces from a wider variety of non-banking competitors as well as banks.

#### Change in Bank Control Act

Under the Change in Control Act, no person, acting directly or indirectly or through or in concert with one or more other persons, may acquire “control” of any Federally insured depository institution unless the appropriate Federal banking agency has been given 60 days prior written notice of the proposed acquisition and within that period has not issued a notice disapproving of the proposed acquisition or has issued written notice of its intent not to disapprove the action. The period for the agency’s disapproval may be extended by the agency. Upon receiving such notice, the Federal agency is required to provide a copy to the appropriate state regulatory agency, if the institution of which control is to be acquired is state chartered, and the Federal agency is obligated to give due consideration to the views and recommendations of the state agency. Upon receiving a notice, the Federal agency is also required to conduct an

investigation of each person involved in the proposed acquisition. Notice of such proposal is to be published and public comment solicited thereon. A proposal may be disapproved by the Federal agency if the proposal would have anticompetitive effects, if the proposal would jeopardize the financial stability of the institution to be acquired or prejudice the interests of its depositors, if the competence, experience or integrity of any acquiring person or proposed management personnel indicates that it would not be in the interest of depositors or the public to permit such person to control the institution, if any acquiring person fails to furnish the Federal agency with all information required by the agency, or if the Federal agency determines that the proposed transaction would result in an adverse effect on a deposit insurance fund. In addition, the Change in Control Act requires that, whenever any Federally insured depository institution makes a loan or loans secured, or to be secured, by 25% or more of the outstanding voting stock of a Federally insured depository institution, the president or chief executive officer of the lending bank must promptly report such fact to the appropriate Federal banking agency regulating the institution whose stock secures the loan or loans.

Dodd-Frank Wall Street Reform and Consumer Protection Act. The federal government is considering a variety of reforms related to banking and the financial industry including, without limitation, the Dodd-Frank Act. The Dodd-Frank Act is intended to promote financial stability in the U.S., reduce the risk of bailouts and protect against abusive financial services practices by improving accountability and transparency in the financial system and ending “too big to fail” institutions. It is the broadest overhaul of the U.S. financial system since the Great Depression, and much of its impact will be determined by the scope and substance of many regulations that will need to be adopted by various regulatory agencies to implement its provisions. For these reasons, the overall impact on DNB and its subsidiaries is unknown at this time.

The Dodd-Frank Act delegates to various federal agencies the task of implementing its many provisions through regulation. Hundreds of new federal regulations, studies and reports addressing all of the major areas of the new law, including the regulation of banks and their holding companies, will be required, ensuring that federal rules and policies in this area will be further developing for months and years to come. Based on the provisions of the Dodd-Frank Act and anticipated implementing regulations, it is highly likely that banks and thrifts as well as their holding companies will be subject to significantly increased regulation and compliance obligations.

The Dodd-Frank Act could require us to make material expenditures, in particular personnel training costs and additional compliance expenses, or otherwise adversely affect our business or financial results. It could also require us to change certain of our business practices, adversely affect our ability to pursue business opportunities we might otherwise consider engaging in, cause business disruptions and/or have other impacts that are as-of-yet unknown to DNB and the Bank. Failure to comply with these laws or regulations, even if inadvertent, could result in negative publicity, fines or additional licensing expenses, any of which could have an adverse effect on our cash flow and results of operations. For example, a provision of the Dodd-Frank Act is intended to preclude bank holding companies from treating future trust preferred securities issuances as Tier 1 capital for regulatory capital adequacy purposes. This provision may narrow the number of possible capital raising opportunities DNB and other bank holding companies might have in the future. As another example, the new law establishes the Consumer Financial Protection Bureau, which has been given substantive rule-making authority under most of the consumer protection regulations affecting the Bank and its customers. The Bureau and new rules it will issue may materially affect the methods and costs of compliance by the Bank in connection with future consumer related transactions.

#### Pennsylvania Banking Laws

Under the Pennsylvania Banking Code of 1965, as amended (“PA Code”), the Registrant is permitted to control an unlimited number of banks, subject to prior approval of the Federal Reserve Board as more fully described above. The

PA Code authorizes reciprocal interstate banking without any geographic limitation. Reciprocity between states exists when a foreign state's law authorizes Pennsylvania bank holding companies to acquire banks or bank holding companies located in that state on terms and conditions substantially no more restrictive than those applicable to such an acquisition by a bank holding company located in that state. Interstate ownership of banks in Pennsylvania with banks in Delaware, Maryland, New Jersey, Ohio, New York and other states is currently authorized. Some state laws still restrict de novo formations of branches in other states, but restrictions on interstate de novo banking have been relaxed by the Dodd-Frank Act. Pennsylvania law also provides Pennsylvania state chartered institutions elective parity with the power of national banks, federal thrifts, and state chartered institutions in other states as authorized by the Federal Deposit Insurance Corporation ("Competing Institutions"). In some cases, this may give state chartered institutions broader powers than national banks such as the Bank, and may increase competition the Bank faces from other banking institutions.

#### Supervision and Regulation — Bank

The operations of the Bank are subject to Federal and State statutes applicable to banks chartered under the banking laws of the United States, to members of the Federal Reserve System and to banks whose deposits are insured by the FDIC. Bank operations are also subject to regulations of the Office of the Comptroller of the Currency ("OCC"), the Federal Reserve Board and the FDIC.

The primary supervisory authority of the Bank is the OCC, who regularly examines the Bank. The OCC has the authority to prevent a national bank from engaging in an unsafe or unsound practice in conducting its business.

Federal and state banking laws and regulations govern, among other things, the scope of a bank's business, the investments a bank may make, the reserves against deposits a bank must maintain, loans a bank makes and collateral it takes, the activities of a bank

with respect to mergers and consolidations and the establishment of branches. All nationally and state chartered banks in Pennsylvania are permitted to maintain branch offices in any county of the state. National bank branches may be established only after approval by the OCC. It is the general policy of the OCC to approve applications to establish and operate domestic branches, including ATMs and other automated devices that take deposits, provided that approval would not violate applicable Federal or state laws regarding the establishment of such branches. The OCC reserves the right to deny an application or grant approval subject to conditions if (1) there are significant supervisory concerns with respect to the applicant or affiliated organizations, (2) in accordance with CRA, the applicant's record of helping meet the credit needs of its entire community, including low and moderate income neighborhoods, consistent with safe and sound operation, is less than satisfactory, or (3) any financial or other business arrangement, direct or indirect, involving the proposed branch or device and bank "insiders" (directors, officers, employees and 10% or greater shareholders) involves terms and conditions more favorable to the insiders than would be available in a comparable transaction with unrelated parties.

The Bank, as a subsidiary of a bank holding company, is subject to certain restrictions imposed by the Federal Reserve Act on any extensions of credit to the bank holding company or its subsidiaries, on investments in the stock or other securities of the bank holding company or its subsidiaries and on taking such stock or securities as collateral for loans. The Federal Reserve Act and Federal Reserve Board regulations also place certain limitations and reporting requirements on extensions of credit by a bank to principal shareholders of its parent holding company, among others, and to related interests of such principal shareholders. In addition, such legislation and regulations may affect the terms upon which any person becoming a principal shareholder of a holding company may obtain credit from banks with which the subsidiary bank maintains a correspondent relationship.

#### Capital Adequacy

Federal banking laws impose on banks certain minimum requirements for capital adequacy. Federal banking agencies have issued certain "risk-based capital" guidelines, and certain "leverage" requirements on member banks such as the Bank. Banking regulators have authority to require higher minimum capital ratios for an individual bank or bank holding company in view of its circumstances.

**New Capital Rules.** On July 2, 2013, the Federal Reserve approved final rules that substantially amend the regulatory risk-based capital rules applicable to the Corporation and the Bank. The FDIC and the OCC have subsequently approved these rules. The final rules were adopted following the issuance of proposed rules by the Federal Reserve in June 2012, and implement the "Basel III" regulatory capital reforms and changes required by the Dodd-Frank Act. "Basel III" refers to two consultative documents released by the Basel Committee on Banking Supervision in December 2009, the rules text released in December 2010, and loss absorbency rules issued in January 2011, which include significant changes to bank capital, leverage and liquidity requirements.

The rules include new risk-based capital and leverage ratios, which will be phased in from 2015 to 2019, and refine the definition of what constitutes "capital" for purposes of calculating those ratios. The new minimum capital level requirements applicable to the Corporation and the Bank under the final rules effective as of January 1, 2015: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6% (increased from 4%); (iii) a total capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4% for all institutions. The final rules also establish a "capital conservation buffer" above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. The capital conservation buffer will be phased-in over four years beginning on January 1, 2016, as follows: the maximum buffer will be 0.625% of risk-weighted assets for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter. This will result in the following minimum ratios beginning in 2019: (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. Under the final rules, institutions are subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These

limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

The final rules implement revisions and clarifications consistent with Basel III regarding the various components of Tier 1 capital, including common equity, unrealized gains and losses, as well as certain instruments that will no longer qualify as Tier 1 capital, some of which will be phased out over time. However, the final rules provide that small depository institution holding companies with less than \$15 billion in total assets as of December 31, 2009 (which includes the Corporation) will be able to permanently include non-qualifying instruments that were issued and included in Tier 1 or Tier 2 capital prior to May 19, 2010 in additional Tier 1 or Tier 2 capital until they redeem such instruments or until the instruments mature.

The final rules also contain revisions to the prompt corrective action framework, which is designed to place restrictions on insured depository institutions, including the Bank, if their capital levels begin to show signs of weakness. These revisions took effect January 1, 2015. Under the prompt corrective action requirements, which are designed to complement the capital conservation buffer, insured depository institutions are required to meet the following increased capital level requirements in order to qualify as “well capitalized:” (i) a new common equity Tier 1 capital ratio of 6.5%; (ii) a Tier 1 capital ratio of 8% (increased from 6%); (iii) a total capital ratio of 10% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 5% (increased from 4%).

The final rules set forth certain changes for the calculation of risk-weighted assets, which have been required to utilize since January 1, 2015. The standardized approach final rule utilizes an increased number of credit risk exposure categories and risk weights,

and also addresses: (i) an alternative standard of creditworthiness consistent with Section 939A of the Dodd-Frank Act; (ii) revisions to recognition of credit risk mitigation; (iii) rules for risk weighting of equity exposures and past due loans; (iv) revised capital treatment for derivatives and repo-style transactions; and (v) disclosure requirements for top-tier banking organizations with \$50 billion or more in total assets that are not subject to the “advance approach rules” that apply to banks with greater than \$250 billion in consolidated assets. Based on our current capital composition and levels, we believe that we are in compliance with the requirements as set forth in the final rules presently in effect.

**Minimum Capital Ratios.** The risk-based guidelines require all banks to maintain two “risk-weighted assets” ratios. The first is a minimum ratio of total capital (“Tier 1” and “Tier 2” capital) to risk-weighted assets equal to 8.00%; the second is a minimum ratio of “Tier 1” capital to risk-weighted assets equal to 4.00%. Assets are assigned to five risk categories, with higher levels of capital being required for the categories perceived as representing greater risk. In making the calculation, certain intangible assets must be deducted from the capital base. The risk-based capital rules are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies and to minimize disincentives for holding liquid assets.

The risk-based capital rules also account for interest rate risk. Institutions with interest rate risk exposure above a normal level would be required to hold extra capital in proportion to that risk. A bank’s exposure to declines in the economic value of its capital due to changes in interest rates is a factor that the banking agencies will consider in evaluating a bank’s capital adequacy. The rule does not codify an explicit minimum capital charge for interest rate risk. The Bank currently monitors and manages its assets and liabilities for interest rate risk, and management believes that the interest rate risk rules which have been implemented and proposed will not materially adversely affect our operations.

The “leverage” ratio rules require banks which are rated the highest in the composite areas of capital, asset quality, management, earnings, liquidity and sensitivity to market risk to maintain a ratio of “Tier 1” capital to “adjusted total assets” (equal to the bank’s average total assets as stated in its most recent quarterly Call Report filed with its primary federal banking regulator, minus end-of-quarter intangible assets that are deducted from Tier 1 capital) of not less than 3.00%. For banks which are not the most highly rated, the minimum “leverage” ratio will range from 4.00% to 5.00%, or higher at the discretion of the bank’s primary federal regulator, and is required to be at a level commensurate with the nature of the level of risk of the bank’s condition and activities.

For purposes of the capital requirements, “Tier 1” or “core” capital is defined to include common stockholders’ equity and certain non-cumulative perpetual preferred stock and related surplus. “Tier 2” or “qualifying supplementary” capital is defined to include a bank’s allowance for loan and lease losses up to 1.25% of risk-weighted assets, plus certain types of preferred stock and related surplus, certain “hybrid capital instruments” and certain term subordinated debt instruments.

**Prompt Corrective Action.** Federal banking law mandates certain “prompt corrective actions,” which Federal banking agencies are required to take, and certain actions which they have discretion to take, based upon the capital category into which a Federally regulated depository institution falls. Regulations have been adopted by the Federal bank regulatory agencies setting forth detailed procedures and criteria for implementing prompt corrective action in the case of any institution that is not adequately capitalized. Under the rules, an institution will be deemed to be “adequately capitalized” or better if it exceeds the minimum Federal regulatory capital requirements. However, it will be deemed “undercapitalized” if it fails to meet the minimum capital requirements, “significantly undercapitalized” if it has a total risk-based capital ratio that is less than 6.0%, a Tier 1 risk-based capital ratio that is less than 3.0%, or a leverage ratio that is less than 3.0%, and “critically undercapitalized” if the institution has a ratio of tangible equity to total assets that is equal to or less than 2.0%. The rules require an undercapitalized institution to file a written capital restoration plan, along with a performance guaranty by its holding company or a third party. In addition, an undercapitalized institution



becomes subject to certain automatic restrictions including a prohibition on the payment of dividends, a limitation on asset growth and expansion, and in certain cases, a limitation on the payment of bonuses or raises to senior executive officers, and a prohibition on the payment of certain “management fees” to any “controlling person”. Institutions that are classified as undercapitalized are also subject to certain additional supervisory actions, including increased reporting burdens and regulatory monitoring, a limitation on the institution’s ability to make acquisitions, open new branch offices, or engage in new lines of business, obligations to raise additional capital, restrictions on transactions with affiliates, and restrictions on interest rates paid by the institution on deposits. In certain cases, bank regulatory agencies may require replacement of senior executive officers or directors, or sale of the institution to a willing purchaser. If an institution is deemed to be “critically undercapitalized” and continues in that category for four quarters, the statute requires, with certain narrowly limited exceptions, that the institution be placed in receivership.

Based on management’s assessment, the Bank is “well capitalized” for regulatory capital purposes. Please see the table detailing the Bank’s compliance with minimum capital ratios, in Note 17 (“Regulatory Matters”) to DNB’s audited financial statements in this Form 10-K.

Under the Federal Deposit Insurance Act, the OCC possesses the power to prohibit institutions regulated by it, such as the Bank, from engaging in any activity that would be an unsafe and unsound banking practice and in violation of the law. Moreover, Federal law enactments have expanded the circumstances under which officers or directors of a bank may be removed by the institution’s Federal supervisory agency; unvested and further regulated lending by a bank to its executive officers, directors, principal shareholders or related interests thereof; and unvested management personnel of a bank from serving as directors or in other management positions with certain

depository institutions whose assets exceed a specified amount or which have an office within a specified geographic area; and unvested management personnel from borrowing from another institution that has a correspondent relationship with their bank.

**Interstate Banking.** Federal law permits interstate bank mergers and acquisitions. Limited branch purchases are still subject to state laws. Pennsylvania law permits out-of-state banking institutions to establish branches in Pennsylvania with the approval of the Pennsylvania Department of Banking and Securities, provided the law of the state where the banking institution is located would permit a Pennsylvania banking institution to establish and maintain a branch in that state on substantially similar terms and conditions. It also permits Pennsylvania banking institutions to maintain branches in other states. The Dodd-Frank Act created a more permissive interstate branching regime by permitting banks to establish branches de novo in any state if a bank chartered by such state would have been permitted to establish the branch. Bank management anticipates that interstate banking will continue to increase competitive pressures in the Bank's market by permitting entry of additional competitors, but management is of the opinion that this will not have a material impact upon the anticipated results of operations of the Bank.

**Bank Secrecy Act and OFAC.** Under the Bank Secrecy Act ("BSA"), the Bank is required to report to the Internal Revenue Service, currency transactions of more than \$10,000 or multiple transactions of which the Bank is aware in any one day that aggregate in excess of \$10,000. Civil and criminal penalties are provided under the BSA for failure to file a required report, for failure to supply information required by the BSA or for filing a false or fraudulent report. The Department of the Treasury's Office of Foreign Asset Control ("OFAC") administers and enforces economic and trade sanctions against targeted foreign countries, terrorism sponsoring jurisdictions and organizations, and international narcotics traffickers based on U.S. foreign policy and national security goals. OFAC acts under presidential wartime and national emergency powers and authority granted by specific legislation to impose controls on transactions and freeze foreign assets under U.S. jurisdiction. Acting under authority delegated from the Secretary of the Treasury, OFAC promulgates, develops, and administers the sanctions under its statutes and executive orders. OFAC requirements are separate and distinct from the BSA, but both OFAC requirements and the BSA share a common national security goal. Because institutions and regulators view compliance with OFAC sanctions as related to BSA compliance obligations, supervisory examination for OFAC compliance is typically connected to examination of an institution's BSA compliance. Examiners focus on a banking organization's compliance processes and evaluate the sufficiency of a banking organization's implementation of policies, procedures and systems to ensure compliance with OFAC regulations.

**USA PATRIOT Act.** The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (together with its implementing regulations, the "Patriot Act"), designed to deny terrorists and others the ability to obtain access to the United States financial system, has significant implications for banks and other financial institutions. It required DNB and its subsidiary to implement new policies and procedures or amend existing policies and procedures with respect to, anti-money laundering, compliance, suspicious activity and currency transaction reporting and due diligence on customers, as well as related matters. The Patriot Act permits and in some cases requires information sharing for counter terrorist purposes between federal law enforcement agencies and financial institutions, as well as among financial institutions, and it requires federal banking agencies to evaluate the effectiveness of an institution in combating money laundering activities, both in ongoing examinations and in connection with applications for regulatory approval.

**FDIC Insurance and Assessments.** The Bank's deposits are insured to applicable limits by the FDIC. Under the Dodd-Frank Act, the maximum deposit insurance amount was permanently increased from \$100,000 to \$250,000.

The FDIC has adopted a risk-based premium system that provides for quarterly assessments based on an insured institution's ranking in one of four risk categories based on their examination ratings and capital ratios. Within its risk category, an institution is assigned an initial base assessment which is then adjusted to determine its final assessment

rate based on its level of brokered deposits, secured liabilities and unsecured debt.

The FDIC may take action to increase insurance premiums if the deposit insurance fund is not funded to its regulatory mandated Designated Reserve Ratio (DRR). Currently, the FDIC is required to achieve a DRR of 1.35% by September 30, 2020, and has established a target DRR of 2.0%. Under the Dodd-Frank Act, the FDIC assesses premiums from each institution based on its average consolidated total assets minus its average tangible equity, while utilizing a scorecard method to determine each institution's risk to the deposit insurance fund. The Dodd-Frank Act also requires the FDIC, in setting assessments, to offset the effect of increasing its reserve for the deposit insurance fund on institutions with consolidated total assets of less than \$10 billion. To achieve the mandated DRR consistent with these provisions of the Dodd-Frank Act, the FDIC implemented a rule in 2016 imposing a surcharge of 4.5 basis points on all insured depository institutions with consolidated total assets of \$10 billion or more in addition to their regular assessments. Under the rule, the surcharge would cease once a DRR of 1.35% had been achieved or on December 31, 2018, whichever came first. On September 30, 2018, the DRR reached 1.36%, and the surcharge was eliminated.

Pursuant to these requirements, the FDIC adopted new assessment regulations effective April 1, 2011 that redefined the assessment base as average consolidated assets less average tangible equity. Insured banks with more than \$1.0 billion in assets must calculate quarterly average assets based on daily balances while smaller banks and newly chartered banks may use weekly averages. Average assets would be reduced by goodwill and other intangibles. Average tangible equity equals Tier 1 capital. For institutions with more than \$1.0 billion in assets, average tangible equity is calculated on a weekly basis while smaller institutions may use the quarter-

end balance. The base assessment rate for insured institutions in Risk Category I will range between 5 to 9 basis points and for institutions in Risk Categories II, III, and IV will be 14, 23 and 35 basis points, respectively. An institution's assessment rate will be reduced based on the amount of its outstanding unsecured long-term debt and for institutions in Risk Categories II, III and IV may be increased based on their brokered deposits.

In addition to deposit insurance assessments, banks are subject to assessments to pay the interest on Financing Corporation bonds. The Financing Corporation was created by Congress to issue bonds to finance the resolution of failed thrift institutions. The FDIC sets the Financing Corporation assessment rate every quarter. The current annual Financing Corporation assessment rate is 14 basis points on the deposit insurance assessment base, as defined above, which we anticipate will result in an aggregate estimated FICO assessment payment by the Bank of \$14,000 in 2019.

**Other Laws and Regulations.** The Bank is subject to a variety of consumer protection laws, including the Truth in Lending Act, the Truth in Savings Act adopted as part of the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), the Equal Credit Opportunity Act, the Home Mortgage Disclosure Act, the Electronic Funds Transfer Act, the Real Estate Settlement Procedures Act and the regulations adopted thereunder. In the aggregate, compliance with these consumer protection laws and regulations involves substantial expense and administrative time on the part of the Bank and DNB.

**Regulatory Reform and Legislation.** From time to time, various legislative and regulatory initiatives are introduced in Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to substantially change the financial institution regulatory system. Such legislation could change banking statutes and the operating environment of DNB in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. DNB cannot predict whether any such legislation will be enacted, and, if enacted, the effect that it, or any implementing regulations, would have on its financial condition or results of operations. A change in statutes, regulations or regulatory policies applicable to DNB or our subsidiaries could have a material effect on our business, financial condition and results of operations.

**Effect of Government Monetary Policies.** The earnings of DNB are and will be affected by domestic economic conditions and the monetary and fiscal policies of the United States Government and its agencies (particularly the Federal Reserve Board). The monetary policies of the Federal Reserve Board have had and will likely continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The Federal Reserve Board has a major effect upon the levels of bank loans, investments and deposits through its open market operations in United States Government securities and through its regulation of, among other things, the discount rate on borrowing of member banks and the reserve requirements against member bank deposits. It is not possible to predict the nature and impact of future changes in monetary and fiscal policies.

**Incentive Compensation.** In June 2010, the Federal Reserve Board, OCC and FDIC issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the

organization's board of directors.

The Federal Reserve Board will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as DNB, that are not "large, complex banking organizations." These reviews will be tailored to each organization based on the scope and complexity of the organization's activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization's supervisory ratings, which can affect the organization's ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

In addition, Section 956 of the Dodd-Frank Act required certain regulators (including the FDIC, SEC and Federal Reserve Board) to adopt requirements or guidelines prohibiting excessive compensation. In April and May 2016, the Federal Reserve, jointly with five other federal regulators, published a proposed rule in response to Section 956 of the Dodd-Frank Act, which requires implementation of regulations or guidelines to: (1) prohibit incentive-based payment arrangements that encourage inappropriate risks by certain financial institutions by providing excessive compensation or that could lead to material financial loss, and (2) require those financial institutions to disclose information concerning incentive-based compensation arrangements to the appropriate federal regulator.

The proposed rule identifies three categories of institutions that would be covered by these regulations based on average total consolidated assets, applying less prescriptive incentive-based compensation program requirements to the smallest covered institutions (Level 3) and progressively more rigorous requirements to the larger covered institutions (Level 1). Under the proposed rule, we would fall into the smallest category (Level 3), which applies to financial institutions with average total consolidated assets greater than \$1 billion and less than \$50 billion. The proposed rules would establish general qualitative requirements applicable to all covered entities, which would include (i) prohibiting incentive arrangements that encourage inappropriate risks by providing excessive compensation; (ii) prohibiting incentive arrangements that encourage inappropriate risks that could lead to a material financial loss; (iii) establishing requirements for performance measures to appropriately balance risk and reward; (iv) requiring board of director oversight of incentive arrangements; and (v) mandating appropriate record keeping. Under the proposed rule, larger financial institutions with total consolidated assets of at least \$50 billion would also be subject to additional requirements applicable to such institutions' "senior executive officers" and "significant risk-takers." These additional requirements would not be applicable to us because we currently have less than \$50 billion in total consolidated assets. Comments on the proposed rule were due by July 22, 2016. As of the date of this document, the final rule has not yet been published by these regulators.

All of DNB's revenues are attributable to customers located in the United States, and primarily from customers located in Southeastern Pennsylvania. All of Registrant's assets are located in the United States and in Southeastern Pennsylvania. Registrant has no activities in foreign countries and hence no risks attendant to foreign operations.

## Item 1A. Risk Factors

Investment in DNB's Common Stock involves risk and the market price of DNB's Common Stock may fluctuate significantly in response to a number of factors, including those that follow. The following list contains certain risks that may be unique to DNB and to the banking industry. The following list of risks should not be viewed as an all-inclusive list.

Changes in interest rates could reduce DNB's net interest margin, net interest income, fee income and net income. - Interest and fees on loans and securities, net of interest paid on deposits and borrowings, account for a significant part of DNB's net income. Interest rates are key drivers of DNB's net interest margin and subject to many factors beyond DNB's control. As interest rates change, DNB's net interest income is affected. Increased interest rates in the future could result in DNB's interest expense increasing faster than interest income because of divergence in financial instrument maturities and/or competitive pressures. Because different types of assets and liabilities may react differently and at different times to market interest rate changes, changes in interest rates can increase or decrease DNB's net interest income. When interest-bearing liabilities mature or re-price more quickly than interest earning assets in a period, an increase in interest rates would reduce net interest income. Similarly, when interest earning assets mature or re-price more quickly, and because the magnitude of repricing of interest earning assets is often greater than interest bearing liabilities, falling interest rates would reduce net interest income. In addition, substantially higher interest rates generally reduce loan demand and may result in slower loan growth. Decreases or increases in interest rates could have a negative effect on the spreads between the interest rates earned on assets and the rates of interest paid on liabilities, and therefore decrease DNB's net interest income. Also, changes in interest rates might also impact the values of equity and debt securities under management and administration by DNB's wealth management business, which may have a negative impact on fee income.

If DNB's allowance for credit losses is insufficient to absorb losses in its loan portfolio, DNB's earnings could decrease. - All borrowers carry the potential to default, and DNB's remedies to recover upon a default may not fully satisfy amounts previously loaned by DNB. DNB maintains an allowance for credit losses, which is a reserve established through a provision for credit losses charged to expense, which represents DNB's best estimate of probable credit losses that have been incurred within the existing portfolio of loans. The allowance, in DNB's judgment, is necessary to reserve for estimated credit losses and risks inherent in the loan portfolio. Those risks are affected by, among other things:

- the financial condition and cash flows of the borrowers and/or the projects being financed;
  - the changes and uncertainties as to the future value of the collateral, in the case of collateralized loans;
- the duration of the loans in the portfolio;
- the credit history of the particular borrowers; and
- changes in economic and industry conditions.

The determination of the appropriate level of the allowance for credit losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks using existing qualitative and quantitative information, including those identified above, all of which may undergo material changes. If DNB's assumptions and estimates are incorrect, its allowance for credit losses may not be sufficient to cover losses inherent in its loan portfolio, resulting in additions to the allowance. In addition, changes in economic conditions affecting

borrowers generally or certain borrowers in particular, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of DNB's control, may require an increase in the allowance for credit losses. Bank regulatory authorities periodically review DNB's allowance for credit losses and also may require us to increase the provision for credit losses or recognize additional loan charge-offs based on judgments different than DNB's. An increase in the allowance for credit losses results in a decrease in net income and may have a material adverse effect on DNB's financial condition and results of operations.

ASU 2016-13 will result in a significant change in how we recognize credit losses and may have a material impact on our financial condition or results of operations. - In June 2016, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, 2016-13, "Financial Instruments-Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments," which replaces the current "incurred loss" model for recognizing credit losses with an "expected loss" model referred to as the Current Expected Credit Loss model, or CECL. Under the CECL model, we will be required to present certain financial assets carried at amortized cost, such as loans held for investment and held-to-maturity debt securities, at the net amount expected to be collected. The measurement of expected credit losses is to be based on information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This measurement will take place at the time the financial asset is first added to the balance sheet and periodically thereafter. This differs significantly from the "incurred loss" model required under current GAAP, which delays recognition until it is probable a loss has been incurred. Accordingly, we expect that the adoption of the CECL model will materially affect how we determine our allowance for loan losses and could require us to significantly increase our allowance. Moreover, the CECL model may create more volatility in the level of our allowance for loan losses. If we are required to materially increase our level of allowance for loan and lease losses for any reason, such increase could adversely affect our business, financial condition and results of operations.



The new CECL standard will become effective for the Corporation for fiscal years beginning after December 15, 2019 and for interim periods within those fiscal years. We are currently evaluating the impact the CECL model will have on our accounting, but we expect to recognize a one-time cumulative-effect adjustment to our allowance for credit losses as of the beginning of the first reporting period in which the new standard is effective. We cannot yet determine the magnitude of any such one-time cumulative adjustment or of the overall impact of the new standard on our financial condition or results of operations.

Downgrades in U.S. Government and federal agency securities could adversely affect us. - In addition to causing economic and financial markets disruptions, any downgrades of U.S. Government and federal agency securities and/or failures to raise the U.S. debt limit if necessary in the future, could, among other things, materially adversely affect the market value of the U.S. and other government and governmental agency securities DNB owns, the availability of those securities for use as collateral for borrowing, and its ability to access capital markets on favorable terms, as well as have other material adverse effects on the operation of its business and financial results and condition. In particular, the impact of these events could involve increases in interest rates and disruption in payment systems, money markets and long-term or short-term fixed income markets, which could adversely affect the cost and availability of funding to us. Adverse consequences as a result of any downgrades also could extend to borrowers and, as a result, could adversely affect the borrowers' ability to repay their loans.

DNB's financial condition and results of operations may be adversely affected by regional economic conditions and real estate values. - DNB's loan and deposit activities are largely based in eastern Pennsylvania. As a result, DNB's financial performance is closely tied to economic conditions in this region. While the region experienced generally strong local economic conditions during the past several years, and a downturn in the regional real estate market may adversely affect us because DNB's loans are concentrated in this regional area and a large percentage of its loans are secured by real property, and further declines in real estate values reduce the value of that loan collateral. This may limit the amount DNB may recover on defaulted loans by selling the underlying real estate collateral, which would adversely affect DNB's results of operations. In addition, a significant portion of DNB's loan portfolio consists of commercial real estate loans. The ability of these borrowers to repay their loans is often dependent on the borrower receiving sufficient rental payments. Economic conditions may affect the ability of tenants to make rental payments on a timely basis and/or may cause some tenants not to renew their leases, which may adversely affect a borrower's ability to make loan payments. In addition, if operating expenses, taxes and other expenses associated with commercial real estate properties increase materially, the tenant's ability to repay, and therefore the borrower's ability to make timely loan payments to us, could be adversely affected. Any of these factors could increase the amount of DNB's non-performing loans, increase its provision for credit losses and reduce its net income.

General economic conditions and other events may adversely affect DNB's wealth management business revenues. - A general economic slowdown, disruptions in the financial markets, and other events and occurrences that impact the economy could decrease the value of the assets under management and administration by DNB's wealth management business, which would result in lower fee income and could cause clients to seek alternative investment opportunities with other wealth management or financial services providers, which could result in reduced revenue.

Decreased residential mortgage origination or changes to DNB's residential mortgage related revenues and expenses as a result of actions taken by competitors and regulators could adversely affect DNB's results of operations. - DNB originates and sells residential mortgage loans. Changes in interest rates and pricing decisions by DNB's competitors

in this market affect demand for DNB's mortgage loan products and revenue DNB realizes on the sale of mortgage loans, all of which impact DNB's net income. New regulations, increased regulatory scrutiny, changes in the structure of the secondary mortgage markets and other factors also affect DNB's mortgage loan business, and make it more difficult or costly to operate this business.

DNB may not be able to effectively manage its growth. - DNB's future operating results and financial condition depend to a large extent on its ability to successfully manage its growth. DNB's growth has placed, and will continue to place, significant demands on DNB's management and operating systems and resources. Whether through acquisitions, organic growth or a combination thereof, DNB's ability to expand its business is dependent upon its ability to:

- continue to implement and improve its processes and systems, including credit underwriting, financial, accounting and enterprise risk management;
- comply with an increasing number of new laws, rules and regulations governing its business, and changes to existing laws, rules and regulations;
- scale its information technology systems; and
- maintain appropriate staffing levels.

Addressing issues relating to DNB's growth may divert management from DNB's existing business and may require us to incur additional expenditures to expand DNB's administrative and operational infrastructure and, if DNB is unable to effectively manage and grow its banking franchise, including to the satisfaction of DNB's regulators, DNB's business could be materially and adversely affected. In addition, if DNB is unable to manage its current and future expansion in its operations, DNB may experience compliance, operational

and regulatory problems and delays, have to slow its pace of growth or even stop its market and product expansion, or have to incur additional expenditures beyond current projections to support such growth, any one of which could materially and adversely affect us. If DNB experiences difficulties with the development of new business activities or the integration process of acquired businesses, the anticipated benefits of any particular acquisition may not be realized fully, or at all, or may take longer to realize than expected. Additionally, DNB may be unable to recognize synergies, operating efficiencies and/or expected benefits within expected timeframes and cost projections, or at all. DNB also may not be able to preserve the goodwill of an acquired financial institution. DNB's growth could lead to increases in its legal, audit, administrative and financial compliance costs, which could materially and adversely affect us.

DNB may need to raise additional capital in the future and such capital may not be available when needed or at all. - DNB may need to raise additional capital in the future to provide us with sufficient capital resources and liquidity to meet its commitments and business needs. DNB's ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of DNB's control, and its financial performance. DNB's customary sources of liquidity include, but are not limited to, deposits, inter-bank borrowings and borrowings from the Federal Home Loan Bank of Pittsburgh. Any occurrence that may limit DNB's access to the capital markets, such as a decline in the confidence of debt purchasers, depositors or counterparties participating in the capital markets may adversely affect DNB's capital costs and ability to raise capital and, in turn, DNB's liquidity. An inability to raise additional capital on acceptable terms when needed could have a material adverse effect on DNB's business, financial condition and results of operations.

DNB faces strong competition for clients and this competition could affect DNB's operating results. - DNB operates in a highly competitive market and experiences competition in DNB's market from both banks and a variety of other financial institutions. DNB competes with commercial banks, credit unions, savings and loan associations, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market funds, and other mutual funds, as well as other community, super-regional, national, and international financial institutions that operate offices in DNB's primary market areas and elsewhere. DNB competes with these institutions both in attracting deposits and in making loans. Many financial service providers believe DNB's primary market is an attractive market because of its strong economic growth. As a result, DNB is experiencing particularly intense competition in DNB's primary marketplace. While DNB's strategy is to attract customers by providing personalized services and making use of the business and personal ties of DNB's management, there is no assurance DNB will keep or increase market acceptance and be able to operate profitably. Many of DNB's competitors are well-established, larger financial institutions. These institutions offer some services, such as extensive and established branch networks, that DNB does not provide. There are also a number of other community banks in its market that share its general marketing focus. There is a risk that DNB will not be able to compete successfully with other financial institutions in its market, and that DNB may have to pay higher interest rates to attract deposits, which could result in reduced profitability. In addition, competitors that are not depository institutions are generally not subject to the extensive regulations that apply to us. All of these factors may adversely impact DNB's ability to maintain or increase profitability.

DNB depends on its executive officers and key personnel, and DNB's ability to operate its business and implement its strategy depends significantly on DNB's ability to attract and retain individuals with experience and relationships in the markets in which DNB operates and intends to expand. - DNB believes that its future success, including the implementation of its strategy, will depend in large part on the skills of its executive management team and ability to motivate and retain these and other key personnel and attract and retain new personnel with expertise and relationships

in the markets DNB now serves and intends to serve. The loss of service of one or more of DNB's executive officers or key personnel, its inability to replace departing personnel and/or its ability to hire new personnel to implement DNB's strategy could limit DNB's growth and could materially adversely affect DNB's business, financial condition, and results of operations. Competition for qualified candidates is intense, and DNB cannot assure you that DNB will be able to retain and recruit management and other key personnel to meet its needs.

Potential limitations on incentive compensation contained in proposed federal agency rulemaking may adversely affect our ability to attract and retain our highest performing team members. - In April 2011 and May 2016, the Federal Reserve, other federal banking agencies and the SEC jointly published proposed rules designed to implement provisions of the Dodd-Frank Act prohibiting incentive compensation arrangements that would encourage inappropriate risk taking at covered financial institutions, which includes a bank or bank holding company with \$1 billion or more in assets, such as DNB. It cannot be determined at this time whether or when a final rule will be adopted and whether compliance with such a final rule will substantially affect the manner in which we structure compensation for our executives and other employees. Depending on the nature and application of the final rules, we may not be able to successfully compete with certain financial institutions and other companies that are not subject to some or all of the rules to retain and attract executives and other high performing employees. If this were to occur, relationships that we have established with our clients may be impaired and our business, financial condition and results of operations could be adversely affected, perhaps materially.

New lines of business or new products and services may subject us to additional risk. - From time to time, DNB may implement new lines of business or offer new products and services within its existing lines of business. There may be substantial risks and uncertainties associated with these efforts, particularly in instances where the markets for those new lines of business or new products or services are not yet fully developed. DNB may invest significant time and resources in developing and marketing new lines of business and/or new products and services. DNB's anticipated timetables for the development and introduction of new lines of business and/or

new products or services may not be achieved, and DNB's price and profitability targets may not prove feasible. In addition, external factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact development and implementation of a new line of business and/or a new product or service. Any new line of business and/or new product or service also could have a significant impact on the effectiveness of DNB's system of internal controls. If DNB fails to successfully manage these risks in the development and implementation of new lines of business and/or new products or services, DNB's business, financial condition and results of operations could be materially adversely affected.

The fair value of DNB's investment securities can fluctuate due to market conditions which, under some circumstances can lead to other-than-temporary impairment. - As of December 31, 2018, the fair value of DNB's investment securities portfolio was approximately \$157.8 million. Factors beyond DNB's control can significantly influence the fair value of DNB's investment securities and can result in adverse changes to their fair value. These factors include, but are not limited to, rating agency actions with respect to the securities, defaults by the issuer or with respect to any underlying securities, and changes in market interest rates and instability in the capital markets. These and other factors could cause other-than-temporary impairments and realized and/or unrealized losses in future periods and declines in other comprehensive income, which could have a material adverse effect on us. The process for determining whether impairment of a security is other-than-temporary typically requires complex, subjective judgments about the future financial performance and liquidity of the issuer and any collateral underlying the security in order to assess the probability of receiving all contractual principal and interest payments on the security.

Changes to estimates and assumptions DNB makes in preparing its financial statements could adversely affect its operating results, reported assets and liabilities, financial condition and capital levels. - The preparation of DNB's financial statements requires management to make certain critical accounting estimates and assumptions that could affect DNB's reported amounts of assets and liabilities and income and expense during the reporting periods. Changes to those estimates or assumptions could materially affect its operating results, reported assets and liabilities, financial condition and capital levels.

If DNB lost a significant portion of its low-cost deposits, it would negatively impact its liquidity and profitability. - DNB's profitability depends in part on DNB's success in attracting and retaining a stable base of low-cost deposits. The competition for these deposits in DNB's markets is strong and customers are increasingly seeking investments that are safe, including the purchase of U.S. Treasury securities and other government-guaranteed obligations, as well as the establishment of accounts at the largest, most-well capitalized banks. If DNB were to lose a significant portion of its low-cost deposits, it would negatively impact its liquidity and profitability.

Changes in accounting standards and policies can be difficult to predict and can materially affect how DNB records and reports its financial results. - DNB's accounting policies and methods are fundamental to how DNB records and reports its financial condition and results of operations. The regulatory bodies that establish accounting standards, including, among others, the Financial Accounting, or FASB, and the SEC, periodically revise or issue new financial accounting and reporting standards that govern the preparation of its financial statements. These changes, and the effects of these changes, can be difficult to predict and can materially impact how DNB records and reports its financial condition and results of operations. DNB could be required to apply new or revised guidance retrospectively, which may result in the revision of prior period financial statements by material amounts. The implementation of new or revised accounting guidance could have a material adverse effect on its reported financial results.

In addition, DNB must exercise judgment in appropriately applying many of its accounting policies and methods so they comply with generally accepted accounting principles. In some cases, DNB may have to select a particular accounting policy or method from two or more alternatives. In some cases, the accounting policy or method chosen might be reasonable under the circumstances and yet might result in its reporting materially different amounts than would have been reported if DNB had selected a different policy or method. Accounting policies are critical to fairly presenting DNB's financial condition and results of operations and may require us to make difficult, subjective or complex judgments about matters that are uncertain.

If DNB fails to maintain an effective system of internal controls, its business could be adversely affected. - DNB is dependent upon maintaining an effective system of internal controls to provide reasonable assurance that transactions and activities are conducted in accordance with established policies and procedures and are all captured and reported in the financial statements. Any system of internal controls, however well designed and operated, is based in part on certain assumptions and expectations of employee conduct and can only provide reasonable, not absolute, assurance that the objectives of the system are met. Any failure to maintain an effective system of internal controls, any failure to adhere to those internal controls, or any circumvention of DNB's controls could have a material adverse effect on its operations, net income, financial condition, reputation and compliance with laws and regulations. Any failure to maintain an effective internal control environment could impact our ability to report our financial results on an accurate and timely basis, which could result in regulatory actions, loss of investor confidence, and an adverse impact on our business operations and stock price.

Technological systems failures, interruptions and security breaches could negatively impact DNB's operations. - Communications and information systems are essential to the conduct of DNB's business, as DNB uses such systems to manage its

customer relationships, its general ledger, its deposits, and its loans. While DNB has established policies and procedures to prevent or limit the impact of systems failures, interruptions, and security breaches, DNB cannot assure you that such events will not occur or that they will be adequately addressed if they do occur. In addition, any compromise of DNB's security systems could deter customers from using DNB's website and DNB's online banking service, which involve the transmission of confidential information. Although DNB relies on commonly-used security and processing systems to provide the security and authentication necessary to effect the secure transmission of data, these precautions may not protect its systems from compromises or breaches of security. In addition, DNB outsources certain of its data processing to third-party providers. If DNB's third-party providers encounter difficulties, or if DNB has difficulty in communicating with them, DNB's ability to adequately process and account for customer transactions could be affected, and DNB's business operations could be adversely impacted. Threats to information security also exist in the processing of customer information through various other vendors and their personnel. The occurrence of any systems failure, interruption, or breach of security could damage DNB's reputation and result in a loss of customers and business, could subject us to additional regulatory scrutiny, or could expose us to civil litigation and possible financial liability. Any of these occurrences could have a material adverse effect on DNB's financial condition and results of operations.

Additionally, financial products and services have become increasingly technology-driven. DNB's ability to meet the needs of its customers competitively, and in a cost-efficient manner, is dependent on DNB's ability to keep pace with technological advances and to invest in new technology as it becomes available. Many of DNB's competitors have greater resources to invest in technology than DNB does and may be better equipped to market new technology-driven products and services. If DNB fails to keep pace with technological change, it could have a material adverse impact on DNB's business.

Loss of, or failure to adequately safeguard, confidential or proprietary information may adversely affect DNB's operations, financial performance or reputation. - DNB regularly collects, processes, transmits and stores significant amounts of confidential information regarding its customers, employees and others. This information is necessary for DNB to conduct its business activities, including the ongoing maintenance of deposit, loan, investment management and other account relationships for DNB's customers, and receiving instructions and completing transactions for DNB's customers and other users of DNB's products and services. In addition, DNB compiles, processes, transmits and stores proprietary, non-public information concerning its business, operations, plans and strategies. In some cases, this confidential or proprietary information is collected, compiled, processed, transmitted or stored by third parties on DNB's behalf. Information security risks have generally increased in recent years because of the proliferation of new technologies and the increased sophistication and activities of perpetrators of cyber-attacks. A failure in or breach of DNB's operational or information security systems, or those of DNB's service providers, as a result of cyber-attacks, information security breaches or otherwise could adversely affect its business, result in the disclosure or misuse of confidential or proprietary information, damage DNB's reputation, increase DNB's costs and/or cause losses. If this confidential or proprietary information were to be mishandled, misused, improperly disclosed or lost, DNB could be exposed to significant regulatory consequences, reputational damage, civil litigation and financial loss. Although DNB employs a variety of safeguards to protect this confidential and proprietary information from mishandling, misuse, improper disclosure or loss, DNB cannot assure you that these safeguards will be effective in every instance, or that if mishandling, misuse, improper disclosure or loss of the information did occur, those events would be promptly detected and addressed. Additionally, as information security risks and cyber threats continue to evolve, DNB may be required to expend additional resources to continue to enhance its information security measures and/or to investigate and remediate any information security vulnerabilities.

Employee errors or misconduct could subject us to financial losses or regulatory sanctions and seriously harm DNB's reputation. - Errors or misconduct by DNB's employees could adversely impact DNB's business. Employee misconduct could include hiding unauthorized activities from us, improper or unauthorized activities on behalf of customers or improper use of confidential information. It is not always possible to prevent employee errors and misconduct, and the precautions DNB takes to prevent and detect this activity may not be effective in all cases. Employee errors could also subject us to financial claims for negligence. Although DNB maintains a system of internal controls and insurance coverage to mitigate operational risks, including employee errors and customer or employee fraud, should those internal controls fail to prevent or detect errors or improper actions, or if any resulting loss is not insured or exceeds applicable insurance limits, DNB's business and reputation could be adversely affected.

Environmental risks associated with DNB's lending activities could adversely affect its financial condition and results of operations. - A significant portion of DNB's loan portfolio is secured by real property. In the course of its business, DNB may own or foreclose on and take title to real estate, which could result in DNB's being subject to environmental liabilities with respect to these properties. DNB may become responsible to a governmental agency or third parties for property damage, personal injury, investigation and clean-up costs incurred by those parties in connection with environmental contamination, or DNB may be required to investigate or clean-up hazardous or toxic substances, or chemical releases at a property. The costs associated with environmental investigation or remediation activities could be substantial. If DNB were to become subject to significant environmental liabilities, it could have a material adverse effect on DNB's financial condition and results of operations.

Severe weather, natural disasters, acts of war or terrorism and other external events could adversely affect DNB's business. - A variety of events over which DNB has no control, including severe weather, natural disasters, acts of war or terrorism and others could have a significant adverse effect on its business. Events such as these could affect the stability of its deposit base, impair the ability



of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant damage to properties funded by DNB's loans, result in loss of revenue and/or cause us to incur additional expenses.

Potential additional acquisitions in the future may disrupt DNB's business and dilute shareholder value. - DNB may pursue additional acquisitions of other financial institutions in the future as part of its growth strategy. As a result, DNB may engage in negotiations or discussions that, if they were to result in a transaction, could have a material effect on its business, operating results and financial condition. In any acquisition, DNB may pay for the acquisition through the payment of cash, the issuance of its common stock or other securities, or a combination thereof. Depending on the size of the acquisition, the amount DNB pays may be material. Using cash in connection with any acquisition could materially affect DNB's cash resources or require us to incur indebtedness. Using shares of common stock as payment could dilute the ownership interest of current shareholders. In addition, the required accounting treatment for certain acquisitions could result in us having to recognize a charge against earnings, which could materially and adversely affect DNB's results of operations during the period in which the charge is recognized. In addition, if goodwill recorded in connection with our prior or potential future acquisitions were determined to be impaired, then we would be required to recognize a charge against our earnings, which could materially and adversely affect our results of operations during the period in which the impairment was recognized. Any potential charges for impairment related to goodwill would not directly impact cash flow or tangible capital.

Acquisition activities generally involve a number of additional risks and potential effects on us and DNB's business, including:

- the time and expense associated with identifying and evaluating potential acquisitions and negotiating potential transactions, including the diversion of management resources from the operation of DNB's existing business;
- the time and expense necessary to integrate the operations and personnel of the acquired company; and
- difficulties relating to the conversion of operational, financial, accounting and customer data of the acquired company onto its systems.

DNB may not be successful in addressing the risks and inherent challenges in completing acquisitions. DNB may lose key employees, experience disruption of DNB's business and customer relationships, incur unexpected costs and face a variety of other unanticipated challenges, any of which could result in not achieving the anticipated benefits of an acquisition. If DNB is not able to successfully identify and address the risks and challenges associated with acquisitions, its business may be harmed and its financial position and results of operations could be materially and adversely affected.

Attractive acquisition opportunities may not be available to us in the future, which could limit the growth of DNB's business. - DNB's future growth may depend, in part, on its ability to expand its business through additional acquisitions of other financial institutions in the future. DNB expects that other banking and financial service companies, many of which have significantly greater resources than us, will compete with us in seeking to complete such acquisitions. This could decrease our chances of growing through acquisitions and increase prices for potential acquisition opportunities that DNB believes are attractive. Also, DNB's acquisitions are subject to various regulatory approvals. If DNB fails to receive the appropriate regulatory approvals for a proposed acquisition, DNB will not be able to complete a transaction which DNB believes to be in its best interests. DNB's regulators consider its capital,

liquidity, profitability, regulatory compliance and levels of goodwill and intangibles, among other factors, when considering DNB's acquisition and expansion proposals. If DNB is unable to pursue and complete acquisitions, its ability to grow its business could be adversely affected.

DNB operates in a highly regulated environment, and the laws and regulations that govern its operations, changes in those laws and regulations, or its failure to comply with applicable laws and regulations, could materially and adversely affect us. - DNB is subject to extensive regulation, supervision, and legislation that govern almost all aspects of its operations. These are intended to protect customers, depositors and the FDIC's Deposit Insurance Fund and not shareholders. Among other things, these laws and regulations prescribe minimum capital requirements, impose limitations on its business activities, limit the dividends or distributions that DNB can pay, restrict the ability of DNB First to engage in transactions with DNB, and impose certain specific accounting requirements on us that may be more restrictive and may result in greater or earlier charges to earnings or reductions in its capital than GAAP. Compliance with laws and regulations can be difficult and costly, and changes to laws and regulations often impose additional compliance costs, and may make certain business practices or products impermissible or uneconomic. DNB's failure to comply with these laws and regulations, even if the failure follows good faith effort or reflects a difference in interpretation, could subject us to restrictions on its business activities, reputational harm, fines and other penalties, any of which could materially and adversely affect us. Further, any new laws, rules and regulations could make compliance more difficult or expensive and also materially and adversely affect us.

Our business, financial condition, results of operations and future prospects could be adversely affected by the highly regulated environment in which we operate. - As a bank holding company, we are subject to federal supervision and regulation. Federal regulation of the banking industry, along with tax and accounting laws, regulations, rules and standards, may limit our operations significantly and control the methods by which we conduct business, just as they limit those of other banking organizations. In addition,

compliance with laws and regulations can be difficult and costly, and changes to laws and regulations can impose additional compliance costs. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), which imposes significant regulatory and compliance changes on financial institutions, is an example of this type of federal regulation. Many of these regulations are intended to protect depositors, customers, the public, the banking system as a whole, or the FDIC insurance funds, not stockholders. Regulatory requirements and discretion affect our lending practices, capital structure, investment practices, dividend policy and many other aspects of our business. There are laws and regulations which restrict transactions between us and our subsidiaries. These requirements may constrain our operations, and the adoption of new laws and changes to or repeal of existing laws may have a further impact on our business, financial condition, results of operations and future prospects. Also, the burden imposed by those federal and state regulations may place banks in general, including our Bank in particular, at a competitive disadvantage compared to their non-banking competitors. We are also subject to requirements with respect to the confidentiality of information obtained from clients concerning their identities, business and personal financial information, employment, and other matters. We require our personnel to agree to keep all such information confidential and we monitor compliance. Failure to comply with confidentiality requirements could result in material liability and adversely affect our business, financial condition, results of operations and future prospects.

Bank holding companies and financial institutions are extensively regulated and currently face an uncertain regulatory environment. Applicable laws, regulations, interpretations, enforcement policies and accounting principles have been subject to significant changes in recent years, and may be subject to significant future changes. Future changes may have a material adverse effect on our business, financial condition and results of operations.

Federal and state regulatory agencies may adopt changes to their regulations or change the manner in which existing regulations are applied. We cannot predict the substance or effect of pending or future legislation or regulation or the application of laws and regulations to DNB. Compliance with current and potential regulation, as well as regulatory scrutiny, may significantly increase our costs, impede the efficiency of our internal business processes, require us to increase our regulatory capital, and limit our ability to pursue business opportunities in an efficient manner by requiring us to expend significant time, effort and resources to ensure compliance and respond to any regulatory inquiries or investigations. In addition, press coverage and other public statements that assert some form of wrongdoing by financial services companies (including press coverage and public statements that do not involve us) may result in regulatory inquiries or investigations, which, independent of the outcome, may be time-consuming and expensive and may divert time, effort and resources from our business. Evolving regulations and guidance concerning executive compensation may also impose limitations on us that affect our ability to compete successfully for executive and management talent.

In addition, given the current economic and financial environment, regulators may elect to alter standards or the interpretation of the standards used to measure regulatory compliance or to determine the adequacy of liquidity, certain risk management or other operational practices for financial services companies in a manner that impacts our ability to implement our strategy and could affect us in substantial and unpredictable ways, and could have a material adverse effect on our business, financial condition and results of operations. Furthermore, the regulatory agencies have extremely broad discretion in their interpretation of the regulations and laws and their interpretation of the quality of our loan portfolio, securities portfolio and other assets. If any regulatory agency’s assessment of the quality of our assets, operations, lending practices, investment practices, capital structure or other assets of our business differs from our assessment, we may be required to take additional charges or undertake or refrain from taking actions that would have the effect of materially reducing our earnings, capital ratios and share price.

New capital rules that were recently issued generally require insured depository institutions and certain holding companies to hold more capital. The impact of the new rules on DNB's financial condition and operations is uncertain. - In July 2013, U.S. federal bank regulatory agencies issued final rules that substantially amended the regulatory risk-based capital rules applicable to DNB and DNB First. The new rules revise, among other things, risk-based capital requirements and the method for calculating risk weighted assets to make those standards consistent with agreements that were reached by Basel III and certain provisions of the Dodd-Frank Act. Certain requirements of the rule began to phase in on January 1, 2015 and the requirements of the rule were fully implemented as of January 1, 2019. The new rules include certain new and higher risk-based capital and leverage requirements than those currently in place. In addition, in order to avoid restrictions on capital distributions (including dividends) or discretionary bonus payments to executives, a covered banking organization must maintain a "capital conservation buffer" on top of its minimum risk-based capital requirements. Furthermore, in the current economic and regulatory environment, bank regulators may impose capital requirements that are more stringent than those required by applicable existing regulations. The application of more stringent capital requirements for us could, among other things, result in lower returns on equity, require the raising of additional capital, and result in regulatory actions if DNB were to be unable to comply with such requirements. Implementation of changes to asset risk weightings for risk based capital calculations, items included or deducted in calculating regulatory capital or additional capital conservation buffers, could result in modifications to its business strategy and could limit its ability to make distributions, including paying dividends or repurchasing its shares. In December 2017, the Basel Committee on Banking Supervision published standards that it described as the finalization of the Basel III regulatory framework (commonly referred to as Basel IV). Among other things, these standards revise the Basel Committee's standardized approach for credit risk and provide a new standardized approach for operational risk capital. Under the Basel framework, these standards will generally be effective on January 1, 2022, with an aggregate output floor phasing in through January 1, 2027. Under the current U.S. capital rules, operational risk capital requirements and a capital floor apply only to advanced approaches institutions,

and not to DNB or the Bank. The impact of Basel IV on us will depend on the manner in which it is implemented by the federal bank regulators.

The FDIC's restoration plan and the related increased assessment rate could materially and adversely affect us. - The FDIC insures deposits at FDIC-insured depository institutions, including DNB First, up to applicable limits. The amount of a particular institution's deposit insurance assessment is based on that institution's risk classification under an FDIC risk-based assessment system. An institution's risk classification is assigned based on certain factors, including capital levels and the level of supervisory concern regulators believe the institution poses. Market developments have significantly depleted the FDIC Deposit Insurance Fund, or DIF, and reduced the ratio of reserves to insured deposits. As a result of recent economic conditions and the enactment of the Dodd-Frank Act, the FDIC has increased the deposit insurance assessment rates and thus raised deposit insurance premiums for insured depository institutions. If these increases are insufficient for the DIF to meet its funding requirements, there may need to be further special assessments or increases in deposit insurance premiums. DNB is generally unable to control the amount of premiums that DNB is required to pay for FDIC insurance. If there are additional bank or financial institution failures, DNB may be required to pay even higher FDIC premiums than the recently increased levels. Any future additional assessments, increases or required prepayments in FDIC insurance premiums may materially and adversely affect us, including by reducing DNB's profitability or limiting its ability to pursue certain business opportunities.

The Consumer Financial Protection Bureau may reshape consumer financial laws through rulemaking and enforcement of unfair, deceptive or abusive practices, which may directly impact DNB's business practices relating to consumer financial products or services. - The Consumer Financial Protection Bureau, or CFPB, has broad rulemaking authority to administer and carry out the purposes and objectives of the "Federal consumer financial laws, and to prevent evasions thereof," with respect to all financial institutions that offer financial products and services to consumers. The CFPB is also authorized to prescribe rules applicable to any covered person or service provider identifying and prohibiting acts or practices that are "unfair, deceptive, or abusive" in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service ("UDAP authority"). The potential reach of the CFPB's broad new rulemaking powers and UDAP authority on the operations of financial institutions offering consumer financial products or services, including us, is currently unknown.

DNB First is subject to federal and state and fair lending laws and failure to comply with these laws could lead to material penalties. - Federal and state fair lending laws and regulations, such as the Equal Credit Opportunity Act and the Fair Housing Act, impose nondiscriminatory lending requirements on financial institutions. The Department of Justice, CFPB, and other federal and state agencies are responsible for enforcing these laws and regulations. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. A successful challenge to DNB First's performance under the fair lending laws and regulations could adversely impact DNB First's rating under the Community Reinvestment Act and result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on merger and acquisition activity and restrictions on expansion activity, which could negatively impact DNB's reputation, business, financial condition and results of operations.

DNB faces a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations. - The Bank Secrecy Act, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "PATRIOT Act") and other laws and regulations require financial institutions, including us, to institute and maintain an effective anti-money laundering program and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network, established by the Treasury Department to administer the Bank Secrecy Act, is authorized to impose significant civil money penalties for violations of those requirements, and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the Justice Department, Drug Enforcement Administration and Internal Revenue Service. There is also increased scrutiny of compliance with the rules enforced by the Office of Foreign Assets Control (the "OFAC"). If its policies, procedures and systems are deemed deficient, DNB would be subject to liability, including fines and regulatory actions, including possible restrictions on DNB's ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of its business plan, which could materially and adversely affect us. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us.

DNB's share price may change for a variety of reasons, some of which are beyond DNB's control. - DNB's share price can fluctuate in response to a variety of factors, some of which are not under DNB's control. These factors could cause the share price to decrease regardless of DNB's operating results. These factors include:

- DNB's financial condition, performance, creditworthiness and prospects;
- DNB's past and future dividend practice;
  - operating results that vary from the expectations of management, securities analysts and investors;
- quarterly variations in DNB's operating results or in the quality of DNB's assets;
- operating results and securities price performance of companies that investors believe are comparable to us;
- the credit, mortgage and housing markets, the markets for securities relating to mortgages or housing, and developments with respect to financial institutions generally;
- future sales of DNB's equity or equity-related securities;
- changes in global financial markets and global economies and general market conditions, such as interest or foreign exchange rates, stock, commodity or real estate valuations or volatility and other geopolitical, regulatory or judicial events; and
- ineffective internal controls over financial reporting

In addition, DNB's share price can be affected by the level of trading in its common stock. The trading volume for the common stock has historically been less than that of larger financial services companies. In light of the relatively low trading volume, significant sales of its common stock in the public market, or the perception that those sales may occur, could cause the trading price of the common stock to decline or to be lower than it otherwise might be in the absence of those sales or perceptions.

DNB may sell additional shares of its common stock or other securities that are convertible into or exchangeable for its common stock, which may adversely affect the market price of DNB's common stock. - DNB is not restricted from issuing additional shares of common stock or other securities, including securities that may be convertible into or exchangeable for shares of its common stock. Some of these securities may have distribution rights in connection with liquidation or other rights, including dividend and voting rights, senior to the rights of DNB's common stock. The future issuance of shares of common stock or other securities could have a dilutive effect on the holders of DNB's common stock. Additionally, the market value of DNB's common stock could decline as a result of sales by us of a large number of shares of common stock or other securities or the perception that such sales could occur.

Provisions in DNB's articles of incorporation and bylaws may inhibit a takeover of us, which could discourage transactions that would otherwise be in the best interests of DNB's shareholders and could entrench management. - Provisions of DNB's amended and restated articles of incorporation and amended and restated bylaws, and applicable provisions of Pennsylvania law may delay, inhibit or prevent someone from gaining control of its business through a tender offer, business combination, proxy contest or some other method even though some shareholders might believe a change in control is desirable.

DNB relies on dividends from DNB First for most of DNB's revenue. - DNB is a bank holding company and its operations are conducted by DNB's subsidiaries from which DNB receives dividends. The ability of DNB's

subsidiaries to pay dividends is subject to legal and regulatory limitations, profitability, financial condition, capital expenditures and other cash flow requirements. The ability of DNB First to pay cash dividends to DNB is limited by its obligation to maintain sufficient capital and by other restrictions on its cash dividends that are applicable to banks. If DNB First is not permitted to pay cash dividends to DNB, it is unlikely that DNB would be able to pay cash dividends on its common stock.

Goodwill Impairment may adversely impact our results of operations. - Impairment of goodwill or other intangible assets could require charges to earnings, which could result in a negative impact on our results of operations. Under current accounting standards, goodwill and certain other intangible assets with indeterminate lives are no longer amortized but, instead, are evaluated for impairment periodically or when impairment indicators are present. Evaluation of goodwill and such other intangible assets could result in circumstances where the applicable intangible asset is deemed to be impaired for accounting purposes. Under such circumstances, the intangible asset's impairment would be reflected as a charge to earnings in the period during which such impairment is identified. Management reviewed the requirements of the qualitative assessments listed in ASC 350-20-35-3C, and resultantly identified nine qualitative assessments that are relevant to the general banking industry and specifically to DNB. These qualitative assessments were intended to isolate change factors which would contribute to the increased risk of impairment of goodwill. The qualitative factors were then used to compare base year levels with current levels to identify potential change factors which could contribute to the increased risk of impairment of goodwill. Based on the results of this analysis, it is more likely than not that the fair value of reporting unit as of the date of this report is higher than its book value and, therefore, goodwill is considered not impaired and no further testing is required pursuant to ASC Topic 350-20.

There is no assurance that we will be successful in overcoming these risks or any other problems encountered in connection with pending or potential acquisitions. Our inability to overcome these risks could have an adverse effect on our levels of reported net income, ROE and ROA, and our ability to achieve our business strategy and maintain our market value.



Uncertainty about the future of the London Interbank Offer Rate (LIBOR) may adversely affect our business and financial results. - LIBOR meaningfully influences market interest rates around the globe. In July 2017, the Chief Executive of the United Kingdom Financial Conduct Authority, which regulates LIBOR, announced its intent to stop persuading or compelling banks to submit rates for the calculation of LIBOR to the administrator of LIBOR after 2021. This announcement indicates that the continuation of LIBOR as currently constructed is not guaranteed after 2021. It is impossible to predict whether and to what extent banks will continue to provide LIBOR submissions to the administrator of LIBOR, whether any additional reforms to LIBOR may be enacted in the United Kingdom or elsewhere, and whether other rate or rates may become accepted alternatives to LIBOR.

In 2014, the FRB and the Federal Reserve Bank of New York convened the Alternative Reference Rates Committee (ARRC) to identify best practices for alternative reference rates, identify best practices for contract robustness, develop an adoption plan, and create an implementation plan with metrics of success and a timeline. The ARRC accomplished its first set of objectives and has identified the Secured Overnight Financing Rate (SOFR) as the rate that represents best practice for use in certain new U.S. dollar derivatives and other financial contracts. The ARRC also published its Paced Transition Plan, with specific steps and timelines designed to encourage adoption of the SOFR. The ARRC was reconstituted in 2018 to help to ensure the successful implementation of the Paced Transition Plan and serve as a forum to coordinate and track planning across cash and derivatives products and market participants currently using LIBOR.

No assurance can be provided that the uncertainties around LIBOR or their resolution will not adversely affect the use, level, and volatility of LIBOR or other interest rates or the value of LIBOR-based securities or other securities or financial arrangements. Further, the viability of SOFR as an alternative reference rate and the availability and acceptance of other alternative reference rates are unclear and also may have adverse effects on market rates of interest and the value of securities and other financial arrangements. These uncertainties, proposals and actions to resolve them, and their ultimate resolution also could negatively impact our funding costs, loan and other asset values, asset-liability management strategies, and other aspects of our business and financial results.

#### Item 1B. Unresolved Staff Comments

None.

#### Item 2. Properties

As of December 31, 2018, DNB owns or leases 15 full-service branch locations, two of which additionally serve as other administrative offices. The following tables detail DNB's properties as of December 31, 2018:

Banking Office	Office Location	Owned/Leased
Boothwyn	3915 Chichester Avenue, Boothwyn, PA 19061	Owned
Caln	1835 East Lincoln Highway, Coatesville, PA 19320	Owned

Chadds Ford	300 Oakland Road, West Chester, PA 19382	Leased
Downingtown	4 Brandywine Avenue, Downingtown, PA 19335	Owned
East End	701 East Lancaster Avenue, Downingtown, PA 19335	Owned
East Falls	4341 Ridge Avenue, Philadelphia, PA 19129	Leased
Exton*	410 Exton Square Parkway, Exton, PA 19341	Leased
Kennett Square	215 East Cypress Street, Kennett Square, PA 19348	Owned
Lionville	891 Pottstown Pike, Exton, PA 19341	Owned
Little Washington	104 Culbertson Run Road, Downingtown, PA 19335	Owned
Ludwig's Corner	1030 North Pottstown Pike, Chester Springs, PA 19425	Owned
Old City	36 North 3rd Street, Philadelphia, PA 19106	Leased
Roxborough	6137 Ridge Avenue, Philadelphia, PA 19128	Leased
West Chester*	124 West Market Street, West Chester, PA 19380	Leased
West Goshen	1115 West Chester Pike, West Chester, PA 19380	Leased
Other Administrative Offices		
Downingtown	4 Brandywine Avenue, Downingtown, PA 19335	Owned
Downingtown	104 Brandywine Avenue, Downingtown, PA 19335	Leased
West Chester	124 West Market Street, West Chester, PA 19380	Leased
*Wealth Management Office		

### Item 3. Legal Proceedings

Neither the Corporation nor any of its subsidiaries is a party to, nor is any of their property the subject of, any material pending legal proceedings other than ordinary routine litigation incidental to their business.

### Item 4. Mine Safety Disclosures

Not Applicable.



## Part II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

## (a) Market Price of and Dividends on Registrant's Common Equity

DNB Financial Corporation's common stock, par value \$1.00 per share, is listed for trading on NASDAQ's Capital Market under the symbol DNB. Current price information is available from account executives at most brokerage firms as well as the firms listed at the back of this report who are market makers of DNB's common stock. There were approximately 550 holders of record who owned 4.3 million shares of common stock outstanding at March 12, 2019. The information required with respect to securities authorized for issuance under DNB's equity compensation plans is set forth in "Item 12 — Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters", and incorporated herein by reference.

## (b) Recent Sales of Unregistered Securities

None.

## (c) Purchases of Equity Securities by DNB and Affiliated Purchasers

The following table provides information on repurchases by or on behalf of DNB or any "affiliated purchaser" (as defined in Regulation 10b-18(a) (3)) of its common stock in each month of the quarter ended December 31, 2018.

Period	Total Number Of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
October 1, 2018 - October 31, 2018	-	\$ -	-	63,016
November 1, 2018 - November 30, 2018	-	-	-	63,016
December 1, 2018 - December 31, 2018	-	-	-	63,016
Total	-	\$ -	-	63,016

On July 25, 2001, DNB authorized the buyback of up to 175,000 shares of its common stock over an indefinite period. On August 27, 2004, DNB increased the buyback from 175,000 to 325,000 shares of its common stock over an indefinite period.

## (d) Corporation Performance Graph

The following graph presents the 5 year cumulative total return on DNB Financial Corporation's common stock, compared to the S&P 500 Index and the S&P 500 Financial Index for the 5 year period ended December 31, 2018. The comparison assumes that \$100 was invested in DNB's common stock and each of the foregoing indices and that all dividends have been reinvested.

#### CORPORATION PERFORMANCE

#### COMPARISON OF FIVE YEAR CUMULATIVE TOTAL RETURN

AMONG DNB FINANCIAL CORP., the S&P 500 INDEX and the S&P 500 FINANCIAL INDEX

## Item 6. Selected Financial Data

The selected financial data set forth below is derived in part from, and should be read in conjunction with, the Consolidated Financial Statements and Notes thereto, contained elsewhere herein.

	At or For the Year Ended December 31									
(Dollars in thousands, except share data)	2018		2017		2016		2015		2014	
RESULTS OF OPERATIONS										
Interest income	\$	46,175	\$	43,385	\$	29,179	\$	24,478	\$	23,596
Interest expense		9,371		5,720		3,324		2,712		2,311
Net interest income		36,804		37,665		25,855		21,766		21,285
Provision for credit losses		1,200		1,660		730		1,105		1,130
Non-interest income		5,245		5,418		6,364		5,009		4,958
Non-interest expense		27,875		28,021		24,641		19,029		18,632
Income before income taxes		12,974		13,402		6,848		6,641		6,481
Income tax expense		2,290		5,456		1,869		1,503		1,677
Net income	\$	10,684	\$	7,946	\$	4,979	\$	5,138	\$	4,804
Preferred stock dividends & accretion of discount		-		-		-		50		135
Net income available to common stockholders	\$	10,684	\$	7,946	\$	4,979	\$	5,088	\$	4,669
PER SHARE DATA										
Basic earnings	\$	2.48	\$	1.87	\$	1.56	\$	1.82	\$	1.69
Diluted earnings		2.48		1.85		1.55		1.79		1.66
Cash dividends		0.28		0.28		0.28		0.28		0.28
Book value		25.88		23.78		22.36		19.65		18.33
Tangible book value (Non-GAAP)		22.21		20.06		18.56		19.58		18.26
Average common shares outstanding		4,303,410		4,260,137		3,186,079		2,801,881		2,766,723
Average diluted common shares outstanding		4,315,324		4,290,070		3,218,884		2,847,488		2,812,726
PERFORMANCE RATIOS										
Return on average assets	0.96	%	0.74	%	0.59	%	0.69	%	0.71	%
Return on average stockholders' equity	10.02		7.93		7.40		8.72		7.78	
Return on average tangible equity (Non-GAAP)	11.78		9.44		9.74		8.73		7.79	
Net interest margin (tax equivalent, Non-GAAP)	3.45		3.73		3.31		3.16		3.36	
Efficiency ratio	65.22		63.75		75.53		68.31		71.12	
Wtd average yield on earning assets	4.32		4.28		3.72		3.51		3.67	
FINANCIAL CONDITION										
Total assets	\$	1,158,235	\$	1,081,915	\$	1,070,685	\$	748,818	\$	723,330
Total liabilities		1,046,389		979,973		975,845		693,330		659,422
Total stockholders' equity		111,846		101,942		94,840		55,488		63,908
Loans, gross		934,971		845,897		817,529		481,758		455,603

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Allowance for credit losses	6,675	5,843	5,373	4,935	4,906					
Investment securities	158,669	174,173	182,206	220,208	231,656					
Goodwill	15,525	15,525	15,590	-	-					
Intangible assets	343	435	537	66	82					
Deposits	984,566	861,203	885,187	606,275	605,083					
Borrowings	55,269	112,803	86,668	81,909	49,005					
ASSET QUALITY RATIOS										
Net charge-offs to average loans	0.04	%	0.15	%	0.05	%	0.23	%	0.19	%
Non-performing loans/total loans	0.62		0.89		1.04		1.06		1.50	
Non-performing assets/total assets	0.94		1.16		1.05		1.02		1.07	
Allowance for credit loss/total loans	0.71		0.69		0.66		1.02		1.08	
Allowance for credit loss/non-performing loans	115.50		77.36		63.20		96.91		71.59	
CAPITAL RATIOS										
Total equity/total assets	9.66	%	9.42	%	8.86	%	7.41	%	8.84	%
Tangible equity/tangible assets (Non-GAAP)	8.40		8.07		7.46		7.40		8.82	
Tier 1 leverage	9.48		9.19		8.42		8.94		10.55	
Common equity tier 1 risk based capital	10.79		10.71		9.60		10.44		10.50	
Tier 1 risk based capital	11.77		11.80		10.67		12.08		14.90	
Total risk based capital	13.61		13.73		12.50		14.78		15.92	

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

I.Introductory Overview

DNB is a bank holding company whose bank subsidiary, the Bank, is a nationally chartered commercial bank with trust powers, and a member of the FDIC. DNB provides a broad range of banking services to individual and corporate customers through its fifteen community offices located throughout Chester, Delaware, and Philadelphia Counties, Pennsylvania. DNB is a community banking organization that focuses its lending and other services on businesses and consumers in the local market area. DNB funds all these activities with retail and business deposits and borrowings. Through its Wealth Management Group, the Bank provides wealth management and trust services to individuals, businesses and non-profit organizations. The Bank and its subsidiary, DNB Investments and Insurance, make available certain non-depository products and services, such as securities brokerage, mutual funds, life insurance and annuities.

DNB earns revenues and generates cash flows by lending funds to commercial and consumer customers in its marketplace. DNB generates its largest source of interest income through its lending function. A secondary source of interest income is DNB's investment portfolio, which provides liquidity and cash flows for future lending needs.

In addition to interest earned on loans and investments, DNB earns revenues from fees it charges customers for non-lending services. These services include wealth management and trust services; brokerage and investment services; cash management services; banking and ATM services; as well as safekeeping and other depository services.

To ensure we remain well positioned to meet the growing needs of our customers and communities and to meet the challenges of the 21st century, we've worked to build awareness of our full-service capabilities and ability to meet the needs of a wide range of customers. This served to not only retain our existing customer base, but to position ourselves as an attractive financial institution on which younger individuals and families can build their dreams. To that end, DNB continues to make appropriate investments in all areas of our business, including people, technology, facilities and marketing.



## Non-GAAP Based Financial Measures

Our selected financial data contains non-GAAP financial measures calculated using non-GAAP amounts. These measures are tangible book value per common share and return on average tangible equity. Tangible book value per share adjusts the numerator by the amount of Goodwill and Other Intangible Assets (reduction of Shareholders' Equity). Return on average tangible equity adjusts the denominator by the amount of Goodwill and Other Intangible Assets (reduction of Shareholders' Equity). Management uses non-GAAP measures to present historical periods comparable to the current period presentation. In addition, management believes the use of non-GAAP measures provides additional clarity when assessing our financial results and use of equity. Disclosures of this type should not be viewed as substitutes for results determined to be in accordance with U.S. GAAP, nor are they necessarily comparable to non-GAAP performance measures that may be presented by other entities.

## Reconciliation of Book Value Per Common Share to Tangible Book Value Per Common Share

	December 31,	
(Dollars in thousands, except share and per share data)	2018	2017
Stockholders' Equity	\$ 111,846	\$ 101,942
Goodwill	15,525	15,525
Other intangible assets	343	435
Tangible common equity (Non-GAAP)	\$ 95,978	\$ 85,982
Outstanding shares	4,321,745	4,286,117
Book value per common share (GAAP)	\$ 25.88	\$ 23.78
Tangible book value per common share (Non-GAAP)	22.21	20.06

## Return on Average Tangible Equity (Non-GAAP)

	Year Ended December 31,			
(Dollars in thousands)	2018		2017	
Average Stockholders' Equity	\$ 106,628		\$ 100,212	
Average goodwill	15,525		15,540	
Average other intangible assets	388		485	
Average tangible stockholders' equity (Non-GAAP)	\$ 90,715		\$ 84,187	
Return on average tangible equity (Non-GAAP)	11.78	%	9.44	%

## Tax equivalent interest on tax-exempt investment securities (Non-GAAP)

	Year Ended December 31,	
(Dollars in thousands)	2018	2017
Interest on tax exempt investment securities (GAAP)	\$ 874	\$ 938
Tax adjustment	226	478
Tax equivalent interest on tax-exempt investment securities (Non-GAAP)	\$ 1,100	\$ 1,416

Tax equivalent interest and fees on loans (Non-GAAP)

	Year Ended December 31,	
(Dollars in thousands)	2018	2017
Interest and fees on loans (GAAP)	\$ 41,851	\$ 39,254
Tax adjustment	114	254
Tax equivalent interest and fees on loans (Non-GAAP)	\$ 41,965	\$ 39,508

Highlights of DNB's results for the year-end December 31, 2018 include:

- For the year ending December 31, 2018, net income was \$10.7 million, or \$2.48 per diluted share, compared with \$7.9 million, or \$1.85 per diluted share, for the same period last year. Net income of \$10.7 million for 2018, generated a return on average assets ("ROAA"), return on average equity ("ROE") and return on average tangible equity ("ROTE") (a non-GAAP measure) of 0.96%, 10.02% and 11.78%, respectively. Full year 2017 results were impacted by a \$1.8 million charge, or \$0.43 per diluted share, to adjust deferred taxes due to the enactment of the Tax Cuts and Jobs Act (the "Tax Act") in December 2017.
- Asset quality remained strong as net charge-offs were 0.04% of total average loans for the year ending December 31, 2018. Total non-performing assets, including loans and other real estate property, were \$10.8 million as of December 31, 2018, compared with \$12.6 million as of December 31, 2017. The ratio of non-performing loans to total loans was 0.62% as of December 31, 2018, versus 0.89% as of December 31, 2017.
- Capital ratios continue to exceed all regulatory guidelines. As of December 31, 2018, the Tier 1 leverage ratio was 9.48%, the Tier 1 risk-based capital ratio was 11.77%, the common equity Tier 1 risk-based capital ratio was 10.79% and the total risk based capital ratio was 13.61%.

DNB is particularly exposed to downturns in the greater Philadelphia region as well as the global and U.S. economies. While certain economic conditions in the U.S. have shown improvement, high levels of U.S. government debt, higher interest rates, as well as economic and political conditions in the global markets may impact DNB's borrowers negatively. Unfavorable general economic trends, reduced availability of commercial credit and a sustained low Labor Force Participation rate, can negatively impact the credit performance of both consumer and commercial credits, resulting in increased write-downs. A worsening of these conditions, such as an economic slowdown or recession, would likely worsen the adverse effects of these difficult market conditions on DNB and other financial institutions.

In addition, DNB's net interest margin has been impacted by these changes in the economy. Management has been aggressive in managing DNB's cost of funds during the year by implementing carefully planned pricing strategies, designed to offset the effects of a flattening yield curve, while matching liquidity needs. Our composite cost of funds for 2018 was 1.12%, compared to 0.73% in 2017. DNB's net interest margin decreased to 3.45% in 2018 from 3.73% in 2017. The decreased net interest margin was primarily caused by the higher volume and higher cost of interest-bearing liabilities in 2018, over 2017.

## II. Overview of Financial Condition — Major Changes and Trends

At December 31, 2018, DNB had consolidated assets of \$1.2 billion and a Tier I/Leverage Capital Ratio of 9.48%. Loans comprise 83.7% of earning assets, while investments and overnight funds constitute the remainder. Assets increased \$76.3 million or 7.1% to \$1.16 billion at December 31, 2018, compared to \$1.08 billion at December 31, 2017. During the same period, investment securities decreased \$15.5 million or 8.9% to \$158.7 million, while the loan portfolio increased \$89.1 million, or 10.53%, to \$935.0 million. At December 31, 2018, commercial loans, a key strategic emphasis, totaled \$778.4 million and represented 83.3% of total loans. Total commercial loans increased \$89.0 million, or 12.9% since December 31, 2017. Loan originations have been prudent and conservative underwriting standards have been maintained. Deposits increased \$123.4 million to \$984.6 million at December 31, 2018. DNB's liabilities are comprised of a high level of core deposits with a low cost of funds, in addition to a

moderate level of brokered deposits and borrowings with costs that are more volatile than core deposits.

Strategic Plan. During the fourth quarter of 2018, DNB updated its strategic plan, focusing on initiatives to increase core earnings and shareholder value. Key strategies include:

- Maintain our focus on increasing core deposits.
- Continue to grow our commercial loan portfolio, while ensuring stable credit quality.
- Leverage treasury management services to deepen relationships with commercial customers and generate incremental fee revenue.
- Strengthen our emphasis on relationship-based banking, through development of consumer products that encourage and reward customer loyalty.
- Increase digital banking adoption rates and introduce emerging technology solutions to enhance customer experience and improve operating efficiency.
- Maintain strong capital ratios to ensure continued, sustainable growth and innovation.
- Intensify focus on expense control and improved operating leverage.

For the year ending December 31, 2018, net income was \$10.7 million, or \$2.48 per diluted share, compared with \$7.9 million, or \$1.85 per diluted share, for the same period last year. Fourth quarter and full year 2017 results were impacted by a \$1.8 million charge, or \$0.43 per diluted share, to adjust deferred taxes due to the enactment of the Tax Cuts and Jobs Act (the “Tax Act”) in December 2017.

Net interest income for the year ended December 31, 2018 was \$36.8 million, which represented an \$861,000 decrease from the year ended December 31, 2017. The net interest margin declined 0.28% to 3.45% for the year ended December 31, 2018 from 3.73% for the year ended December 31, 2017 primarily due to a decrease in interest income recognized on prepayment of acquired loans and the higher cost of interest-bearing liabilities, which was offset by increased volume of interest-earning assets. Interest income for the year ended December 31, 2018 was \$46.2 million, which represented a \$2.8 million increase from the year ended December 31, 2017. The increase in interest income was primarily due to higher volume of interest-earning assets in 2018 compared to 2017. Interest expense for the year ended December 31, 2018 was \$9.4 million, which represented a \$3.7 million increase from the year ended December 31, 2017. The increase in interest expense was primarily due to higher volume and higher market interest rates of interest-bearing liabilities.

Asset quality remained strong as net charge-offs were 0.04% of total average loans for the year ending December 31, 2018. Total non-performing assets, including loans and other real estate property, were \$10.8 million as of December 31, 2018, compared with \$12.6 million as of December 31, 2017. The ratio of non-performing loans to total loans was 0.62% as of December 31, 2018, versus 0.89% as of December 31, 2017.

Total core deposits increased \$34.9 million, or 5.1% since December 31, 2017, and were 72.5% of total deposits as of December 31, 2018. As of the same date, non-interest bearing deposits were 16.7% of total deposits. Time and brokered deposits increased \$88.4 million, or 48.5%, throughout 2018. The Company used these deposits to help fund loan growth due to their more favorable rates and maturities, compared with other funding sources. As of December 31, 2018, the loan-to-deposit ratio was 95.0%. Over the past year, borrowed funds decreased \$57.5 million, or 51%, to \$55.3 million as of December 31, 2018.

DNB’s most significant revenue source continues to be net interest income, defined as total interest income less total interest expense, which in 2018 accounted for approximately 87.53% of total revenue. To produce net interest income and consistent earnings growth over the long-term, DNB must generate loan and deposit growth at acceptable economic spreads within its market area. To generate and grow loans and deposits, DNB must focus on a number of areas including, but not limited to, the economy, branch expansion, sales practices, customer satisfaction and retention, competition, customer behavior, technology, product innovation and credit performance of its customers.

Management has made a concerted effort to improve the measurement and tracking of business lines and overall corporate performance levels. Improved information systems have increased DNB’s ability to track key indicators and enhance corporate performance levels. Better measurement against goals and objectives and increased accountability will be integral in attaining desired loan, deposit and fee income production.

### III.DNB’s Principal Products and Services

**Loans and Lending Services.** DNB's primary source of earnings and cash flows is derived from its lending function. The commercial loan portfolio amounted to \$778.4 million or 83.25% of total loans as of December 31, 2018. DNB focuses on providing these products to small to mid-size businesses throughout Chester, Delaware, and Philadelphia Counties. In keeping with DNB's goal to match customer business initiatives with products designed to meet their needs, DNB offers a wide variety of fixed and variable rate loans that are priced competitively. DNB serves this market by providing funds for the purchase of business property or ventures, working capital lines, Small Business Administration loans, lease financing for equipment and for a variety of other purposes.

As a community bank, DNB also serves consumers by providing home equity and home mortgages, as well as term loans for the purchase of consumer goods. Residential mortgage and consumer loans increased \$119,000 in 2018 compared to 2017, primarily in the residential mortgage portfolio. In addition to providing funds to customers, DNB also provides a variety of services to its commercial customers. These services, such as cash management, remote capture, commercial sweep accounts, internet banking, letters of credit and other lending services are designed to meet our customer needs and help them become successful. DNB provides these services to assist its customers in obtaining financing, securing business opportunities, providing access to new resources and managing cash flows.

**Deposit Products and Services.** DNB's primary source of funds is derived from customer deposits, which are typically generated by DNB's fifteen banking offices. DNB's deposit base, while highly concentrated in central Chester County, extends to southern Chester County and into parts of Delaware, Lancaster, and Philadelphia Counties. In addition, a growing amount of new deposits are being generated through expanded government service offerings and as a part of comprehensive loan or wealth management relationships. DNB also has access to wholesale brokered deposits which amounted to \$108.7 million at December 31, 2018.

The majority of DNB's deposit mix consists of low costing deposits, (demand, NOW and savings accounts). The remaining deposits are comprised of rate-sensitive money market and time products. DNB offers tiered savings and money market accounts,

designed to attract high dollar, less volatile funds. Certificates of deposit and IRAs are traditionally offered with interest rates commensurate with their terms.

**Non-Deposit Products and Services.** DNB offers non-deposit products and services under the names “DNB Investments & Insurance” and “DNB First Investment Management & Trust.” Revenues from these entities were \$2.0 million and \$1.7 million for 2018 and 2017, respectively.

**DNB Investments & Insurance.** Through a third party marketing agreement with Cetera Investment Services, LLC, DNB Investments & Insurance offers a complete line of investment and insurance products, which include the following:

- Fixed & Variable Annuities
- 401(k) Rollovers
- Self-Directed and Managed IRAs
- Mutual Funds
- Long Term Care Insurance
- Life Insurance
- Disability Insurance
- 401(k) plans
- Stocks
- Bonds
- Full Services Brokerage/Cash Management
- 529 College Savings Plans
- Separately Managed Investment Accounts (SMA)
- Self Employed Pension (SEP)

**DNB First Investment Management & Trust.** DNB First Investment Management & Trust offers a full line of investment and fiduciary services, which includes the following:

- Investment Management
- Estate Settlement
- Custody Services
- Corporate Trustee / Trust Administration
- Investment Advisory
- Client Bill Paying
- Financial Planning
- Power of Attorney and Guardian of the Estate Capacities

#### IV. Material Challenges, Risks and Opportunities

##### A. Interest Rate Risk Management.

Interest rate risk is the exposure to adverse changes in net interest income due to changes in interest rates. DNB considers interest rate risk a predominant risk in terms of its potential impact on earnings. Interest rate risk can occur for any one or more of the following reasons: (a) assets and liabilities may mature or re-price at different times; (b) short-term or long-term market rates may change by different amounts; or (c) the remaining maturity of various assets or liabilities may shorten or lengthen as interest rates change.

The principal objective of DNB’s interest rate risk management is to evaluate the interest rate risk included in certain on and off balance sheet accounts, determine the level of risk appropriate given DNB’s business strategy, operating environment, capital and liquidity requirements and performance objectives, and manage the risk consistent with approved guidelines. Through such management, DNB seeks to reduce the vulnerability of its operations to changes in interest rates. DNB’s Asset Liability Committee (the “ALCO”) is responsible for reviewing DNB’s asset/liability policies and interest rate risk position and making decisions involving asset liability considerations. The ALCO meets on a monthly basis and reports trends and DNB’s interest rate risk position to the Board of Directors on a quarterly basis. The extent of the movement of interest rates is an uncertainty that could have a negative impact on DNB’s earnings. (See additional discussion in Item 7a. Quantitative and Qualitative Disclosures About Market Risk of this

Form 10-K.)

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## 1. Net Interest Margin

DNB's net interest margin is the ratio of net interest income to average interest earning assets (tax effected). Unlike the interest rate spread, which measures the difference between the rates on earning assets and interest paying liabilities, the net interest margin measures that spread plus the effect of net free funding sources. This is a more meaningful measure of profitability because a bank can have a narrow spread but a high level of equity and non-interest bearing deposits, resulting in a higher net interest margin. One of the most critical challenges DNB faced over the last several years was the impact of historically low interest rates and a narrower spread between short-term rates and long-term rates as noted in the following tables.

	Historical Rates					
	December 31					
	2018	2017	2016	2015	2014	2013
Prime	5.50 %	4.50 %	3.75 %	3.50 %	3.25 %	3.25 %
Federal Funds Sold ("FFS")	2.50	1.50	0.75	0.50	0.25	0.25
5 Year US Treasury	2.51	2.18	1.96	1.71	1.89	1.83
10 Year US Treasury	2.69	2.40	2.49	2.25	2.46	3.15

	Historical Yield Spread					
	December 31					
	2018	2017	2016	2015	2014	2013
FFS to 5 year US Treasury	0.01 %	0.68 %	1.21 %	1.21 %	1.64 %	1.58 %
FFS to 10 year US Treasury	0.19	0.90	1.74	1.75	2.21	2.90

In general, financial institutions price their fixed rate loans off of 5 and 10 year treasuries and price their deposits off of shorter indices, like the Federal Funds Sold rate. As you can see in the table above, the spread between the Federal Funds Sold rate and the 5 year treasury has ranged from 0.01% to 1.64% during the last 6 years. The spread between the Federal Funds Sold rate and the 10 year treasury has ranged from 0.19% to 2.90% during the last 6 years. As a result of the compression between long and short term rates, many banks, including DNB, have seen their net interest margin contract during the last 6 years.

The following table provides, for the periods indicated, information regarding: (i) DNB's average balance sheet; (ii) the total dollar amounts of interest income from interest earning assets and the resulting average yields (tax-exempt yields have been adjusted to a tax equivalent basis using a 21% tax rate); (iii) the total dollar amounts of interest expense on interest bearing liabilities and the resulting average costs; (iv) net interest income; (v) net interest rate spread; and (vi) net interest margin. Average balances were calculated based on daily balances. Non-accrual loan balances are included in total loans. Loan fees and costs are included in interest on total loans.

## Average Balances, Rates, and Interest Income and Expense

(Dollars in thousands)	Year Ended December 31								
	2018			2017			2016		
	Average	Yield/		Average	Yield/		Average	Yield/	
	Balance	Interest*	Rate	Balance	Interest*	Rate	Balance	Interest*	Rate
<b>ASSETS</b>									
Interest-earning assets:									
Investment securities:									
Taxable	\$ 136,198	\$ 3,220	2.36 %	\$ 140,400	\$ 2,983	2.13 %	\$ 154,827	\$ 2,896	1.87 %
Tax-exempt	39,508	1,100	2.78	43,810	1,416	3.23	53,430	1,825	3.42
Total securities	175,706	4,320	2.46	184,210	4,399	2.39	208,257	4,721	2.27
Cash and cash equivalents	18,376	230	1.25	26,884	210	0.78	30,391	129	0.42
Total loans	882,677	41,965	4.75	819,594	39,508	4.82	571,432	25,310	4.43
Total interest-earning assets	1,076,759	46,515	4.32	1,030,688	44,117	4.28	810,080	30,160	3.72
Non-interest-earning assets	41,177			45,035			28,427		
Total assets	\$ 1,117,936			\$ 1,075,723			\$ 838,507		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>									
Interest-bearing liabilities:									
NOW, money market and savings	\$ 534,466	\$ 3,862	0.72 %	\$ 507,006	\$ 2,289	0.45 %	\$ 428,143	\$ 1,004	0.23 %
Time	136,845	1,982	1.45	157,954	1,257	0.80	101,268	706	0.70
Brokered	79,320	1,662	2.09	33,124	538	1.62	22,491	301	1.34
Total interest-bearing deposits	750,631	7,506	1.00	698,084	4,084	0.59	551,902	2,011	0.36
Federal funds purchased	1,106	21	1.92	143	2	1.22	442	3	0.72
Repurchase agreements	7,516	15	0.20	14,229	28	0.20	19,878	40	0.20
Subordinated debt	9,750	414	4.25	9,750	414	4.25	9,750	414	4.25
FHLBP advances	52,572	887	1.69	54,066	752	1.39	31,965	451	1.41
Other interest-bearing borrowings	11,461	528	4.60	9,673	440	4.54	9,722	405	4.16
Total interest-bearing	833,036	9,371	1.12	785,945	5,720	0.73	623,659	3,324	0.53

## liabilities

Demand deposits	172,042	184,520	142,569
Other liabilities	6,230	5,046	5,179
Stockholders' equity	106,628	100,212	67,100
Total liabilities and stockholders' equity	\$ 1,117,936	\$ 1,075,723	\$ 838,507
Net interest income	\$ 37,144	\$ 38,397	\$ 26,836
Interest rate spread	3.20 %	3.55 %	3.19 %
Net interest margin	3.45 %	3.73 %	3.31 %

\*All amounts are reported on a tax equivalent basis, a non-GAAP measure, computed using the statutory federal income tax rate, exclusive of the alternative minimum tax rate and nondeductible interest expense. The tax equivalent adjustment amounts used in the above table to compute yields aggregated \$340,000 in 2018, \$732,000 in 2017, and \$981,000 in 2016. The tax equivalent net interest margin is calculated by dividing tax equivalent net interest income by average total interest earning assets.

## 2. Rate / Volume Analysis

During 2018, DNB recognized purchase accounting accretion and amortization related to the acquisition of ERB which totaled \$1.0 million in additional net interest income, affecting interest income on loans, and interest expense on time deposits and borrowings, compared to \$2.3 million in 2017. During 2018, net interest income decreased \$1.3 million or 3.26% on a tax equivalent basis. As shown in the following Rate/Volume Analysis table, DNB had \$3.0 million in unfavorable rate changes, offset by \$1.8 million in favorable volume changes.

The unfavorable impact of increased rates on interest-bearing liabilities combined with the unfavorable impact of changes in yields on interest-earning assets resulted in a \$3.0 million unfavorable difference. The unfavorable change due to rate on interest-bearing deposits was \$2.6 million (an average rate paid of 1.00% in 2018, compared to 0.59% in 2017). The unfavorable change due to rate earned on loans was \$542,000 (an average rate earned of 4.75% in 2018, compared to 4.82% in 2017). The unfavorable change due to rate on FHLBP advances was \$160,000 (an average rate paid of 1.69% in 2018, compared to 1.39% in 2017). The unfavorable change due to rate on other interest-bearing accounts was \$6,000 (an average rate paid of 4.60% in 2018, compared to 4.54% in 2017). These unfavorable changes due to higher rates paid on interest-bearing liabilities and lower rates earned on loans (primarily due to a decline in purchase accounting accretion year over year) were partially offset by favorable changes due to higher rates earned on investment securities and cash and cash equivalents. The favorable change due to rate earned on investments was \$140,000 (an average rate earned of 2.46% in 2018, compared to 2.39% in 2017). The favorable change due to rate earned on cash and cash equivalents was \$126,000 (an average rate earned of 1.25% in 2018, compared to 0.78% in 2017). DNB's composite cost of funds was 1.12% in 2018, compared to 0.73% in 2017.

The favorable impact of increased volume of interest-earning assets outweighed the unfavorable impact of increased volume of interest-bearing liabilities, resulting in a \$1.8 million favorable difference. The favorable change in net interest income due to volume changes is mostly attributable to increased average balances of loans of \$63.1 million (affecting net interest income favorably by \$3.0 million), decreased average balances of FHLBP advances of \$1.5 million (favorable change of \$25,000), and decreased average balances of repurchase agreements of \$6.7 million (favorable change of \$13,000), offset by increased average balances of interest-bearing deposits



of \$52.5 million (unfavorable change of \$860,000), decreased average balances of investment securities of \$8.5 million (unfavorable change of \$219,000), decreased average balances of cash and cash equivalents of \$8.5 million (unfavorable change of \$106,000), increased average balances of other interest-bearing accounts of \$1.8 million (unfavorable change of \$82,000), and increased average balances of Federal funds purchased of \$963,000 (unfavorable change of \$18,000).

The following table sets forth, among other things, the extent to which changes in interest rates and changes in the average balances of interest-earning assets and interest-bearing liabilities have affected interest income and expense for the periods noted (tax-exempt yields have been adjusted to a tax equivalent basis using a 21% tax rate in 2018 and a 34% tax rate in years prior to 2018). For each category of interest-earning assets and interest-bearing liabilities, information is provided with respect to changes attributable to (i) changes in rate (change in rate multiplied by old volume) and (ii) changes in volume (change in volume multiplied by new rate). The net change attributable to the combined impact of rate and volume has been allocated proportionately to the change due to rate and the change due to volume.

### Rate / Volume Analysis

(Dollars in thousands)

	2018 Versus 2017 Change Due To			2017 Versus 2016 Change Due To		
	Rate	Volume	Total	Rate	Volume	Total
Interest-earning assets:						
Loans	\$ (542)	\$ 2,999	\$ 2,457	\$ 2,235	\$ 11,963	\$ 14,198
Investment securities:						
Taxable	336	(99)	237	393	(306)	87
Tax-exempt	(196)	(120)	(316)	(98)	(311)	(409)
Cash and cash equivalents	126	(106)	20	109	(28)	81
Total	(276)	2,674	2,398	2,639	11,318	13,957
Interest-bearing liabilities:						
NOW, money market and savings	1,375	198	1,573	928	357	1,285
Time	1,031	(306)	725	100	451	551
Brokered	156	968	1,124	64	173	237
Federal funds purchased	1	18	19	2	(3)	(1)
Repurchase agreements	-	(13)	(13)	-	(12)	(12)
Subordinated notes	-	-	-	-	-	-
FHLBP advances	160	(25)	135	(6)	307	301
Other interest-bearing accounts	6	82	88	37	(2)	35
Total	2,729	922	3,651	1,125	1,271	2,396
Net interest income	\$ (3,005)	\$ 1,752	\$ (1,253)	\$ 1,514	\$ 10,047	\$ 11,561

### 3. Interest Rate Sensitivity Analysis

The largest component of DNB's total income is net interest income, and the majority of DNB's financial instruments are comprised of interest rate-sensitive assets and liabilities with various terms and maturities. The primary objective of management is to maximize net interest income while minimizing interest rate risk. Interest rate risk is derived

from timing differences in the re-pricing of assets and liabilities, loan prepayments, deposit withdrawals, and differences in lending and funding rates. The Asset/Liability Committee (“ALCO”) actively monitors and manages the bank’s interest rate exposure using simulation models and gap analysis. The Committee’s primary objective is to minimize the adverse impact of changes in interest rates on net interest income, while maximizing earnings. Simulation model results show moderate liability sensitivity to rising rates in 100, 200, 300, and 400 basis point shock scenarios. Rate changes ramped in over 24 months also show moderate liability sensitivity.

#### B. Liquidity and Market Risk Management

Liquidity is the ability to meet current and future financial obligations. The Bank further defines liquidity as the ability to respond to deposit outflows as well as maintain flexibility to take advantage of lending and investment opportunities. The Bank’s primary sources of funds are operating earnings, deposits (including brokered deposits), principal and interest payments on loans, proceeds from loan sales, sales and maturities of mortgage-backed and investment securities, and FHLBP advances. The Bank uses the funds generated to support its lending and investment activities as well as any other demands for liquidity such as deposit outflows. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows, mortgage prepayments, loan and security sales and the exercise of call features are greatly influenced by general interest rates, economic conditions and competition.

The objective of DNB’s asset/liability management function is to maintain consistent growth in net interest income within DNB’s policy limits. This objective is accomplished through the management of liquidity and interest rate risk, as well as customer offerings of various loan and deposit products. DNB maintains adequate liquidity to meet daily funding requirements, anticipated deposit withdrawals, or asset opportunities in a timely manner. Liquidity is also necessary to meet obligations during unusual, extraordinary or adverse operating circumstances, while avoiding a significant loss or cost. DNB’s foundation for liquidity is a stable deposit base as well as a marketable investment portfolio that provides cash flow through regular maturities or that can be used for collateral to secure

funding in an emergency. As part of its liquidity management, DNB maintains assets, which comprise its liquidity (Federal funds sold, investments and interest bearing cash balances, less pledged securities).

### C. Credit Risk Management

DNB defines credit risk as the risk of default by a customer or counter party. The objective of DNB's credit risk management strategy is to quantify and manage credit risk on an aggregate portfolio basis as well as to limit the risk of loss resulting from an individual customer default. Credit risk is managed through a combination of underwriting, documentation and collection standards. DNB's credit risk management strategy calls for regular credit examinations and quarterly management reviews of large credit exposures and credits experiencing credit quality deterioration. DNB's loan review procedures provide objective assessments of the quality of underwriting, documentation, risk grading and charge-off procedures, as well as an assessment of the allowance for credit loss reserve analysis process. As the U.S. economy moves through a period of recession, it is possible that delinquencies and non-performing assets may rise as the value of homes decline and DNB's borrowers experience financial difficulty due to corporate downsizing, reduced sales and income levels, or other negative events which will impact their ability to meet their contractual loan payments. To minimize the impact on DNB's earnings and maintain sound credit quality, management continues to aggressively monitor credit and credit relationships that may be impacted by such adverse factors.

### D. Competition

In addition to the challenges related to the interest rate environment, community banks in Chester, Philadelphia and Delaware Counties have been experiencing increased competition from large regional and international banks entering DNB's marketplace through mergers and acquisitions. Competition for loans and deposits has negatively affected DNB's net interest margin. To compensate for the increased competition, DNB, along with other area community banks, has aggressively sought and marketed customers who have been disenfranchised by these mergers.

To attract these customers, DNB offers deposit products and services, such as Choice Checking relationship products, and Online Banking with bill payment, external transfer and account aggregation functionality. DNB also offers a complete package of cash management services including automated clearing house services, remote deposit, payroll services, and merchant services and account payment solutions. Our broad range of Business Checking products provides solutions to meet the needs of a variety of businesses and non-profit organizations.

### V. Critical Accounting Policies and Estimates

The following discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. Generally accepted accounting principles are complex and require management to apply significant judgment to various accounting, reporting and disclosure matters. Management must use assumptions and estimates to apply these principles where actual measurement is not possible or practical. Actual results may differ from these estimates under different assumptions or conditions.

In management's opinion, the most critical accounting policies and estimates impacting DNB's consolidated financial statements are in Note 1 to the Consolidated Financial Statements. These policies are critical because they are highly dependent upon subjective or complex judgments, assumptions and estimates. Changes in such estimates may have a significant impact on the financial statements. For a complete discussion of DNB's significant accounting policies, see the Notes to the Consolidated Financial Statements and discussion throughout this Form 10-K.

### VI. 2018 Financial Results

A. Liquidity

Management maintains liquidity to meet depositors' needs for funds, to satisfy or fund loan commitments, and for other operating purposes. DNB's foundation for liquidity is a stable and loyal customer deposit base, cash and cash equivalents, and a marketable investment portfolio that provides periodic cash flow through regular maturities and amortization, or that can be used as collateral to secure funding. Primary liquidity includes investments, Federal funds sold, and interest bearing cash balances, less pledged securities. DNB also anticipates scheduled payments and prepayments on its loan and mortgage backed securities portfolios. In addition, DNB maintains borrowing arrangements with various correspondent banks, the Federal Home Loan Bank of Pittsburgh and the Federal Reserve Bank of Philadelphia to meet short-term liquidity needs. Through these relationships, DNB has available credit of approximately \$568.6 million at December 31, 2018. At December 31, 2018 DNB also had \$507.0 million of available short or long term funding through several agreements and programs with brokers. Management believes that DNB has adequate resources to meet its short-term and long-term funding requirements.



As of December 31, 2018, deposits totaled \$984.6 million, up \$123.4 million from \$861.2 million at December 31, 2017. There are \$142.6 million in certificates of deposit (including IRAs and brokered time deposits) scheduled to mature during 2019. Management believes that the majority of the non-brokered time deposits will be reinvested with DNB and that certificates that are not renewed will be funded by a reduction in cash and cash equivalents or by pay-downs and maturities of loans and investments. At December 31, 2018, DNB had \$190.8 million in un-funded loan commitments. In addition, there were \$2.3 million in un-funded letters of credit. Management anticipates the majority of these commitments will be funded by means of normal cash flows. Included in interest bearing deposits are time and brokered deposits issued in amounts of \$100,000 or more and their remaining maturities at December 31, 2018 were as follows:

#### Time and Brokered Deposits Greater Than or Equal to \$100,000

(Dollars in thousands)

	December 31, 2018		
	Time	Brokered	
(Dollars in thousands)	Deposits	Time Deposits	Total
Three months or less	\$ 10,800	\$ 1,494	\$ 12,294
Over three through six months	17,991	-	17,991
Over six through twelve months	35,909	-	35,909
Over one year through two years	30,149	-	30,149
Over two years	4,368	-	4,368
Total	\$ 99,217	\$ 1,494	\$ 100,711

The following table sets forth the composition of DNB's deposits at the dates indicated.

#### Deposits By Major Classification

(Dollars in thousands)

	December 31				
	2018	2017	2016	2015	2014
Non-interest-bearing deposits	\$ 164,746	\$ 176,815	\$ 173,467	\$ 125,581	\$ 102,107
Interest-bearing deposits:					
NOW	236,071	199,310	224,219	185,973	205,816
Money market	235,023	221,726	184,783	137,555	143,483
Savings	77,979	81,050	86,176	72,660	66,634
Certificates	144,443	122,653	166,565	55,180	62,747

IRA	17,653	17,837	20,691	10,838	14,058
Brokered	108,651	41,812	29,286	18,488	10,238
Total deposits	\$ 984,566	\$ 861,203	\$ 885,187	\$ 606,275	\$ 605,083

For detailed information regarding the maturity of our time deposits and certificates of deposit, see Note 6 to our Consolidated Financial Statements.

#### B. Capital Resources and Adequacy

Stockholders' equity was \$111.8 million at December 31, 2018, compared to \$101.9 million at December 31, 2017. The increase in stockholders' equity was primarily a result of earnings of \$10.7 million, restricted stock compensation expense of \$315,000, and sales of treasury shares totaling \$584,000. These increases were partially offset by \$1.2 million of dividends paid on DNB's common stock, \$365,000 of taxes on share awards vesting, and \$110,000 of other comprehensive loss. We have modeled our ratios under the finalized Basel III rules and we do not expect that we will be required to raise additional capital as a result of these rules.

Based on management's assessment, DNB and the Bank have exceeded all regulatory guidelines on December 31, 2018. The Bank's capital category is determined for the purposes of applying the bank regulators' "prompt corrective action" regulations and for determining levels of deposit insurance assessments and may not constitute an accurate representation of DNB's or the Bank's overall financial condition or prospects. DNB's capital exceeds the Federal Reserve Bank's ("FRB's") minimum leverage ratio requirements for bank holding companies (see additional discussion in Regulatory Matters — Note 17 to DNB's Consolidated Financial Statements).

Under federal banking laws and regulations, DNB and the Bank are required to maintain minimum capital as determined by certain regulatory ratios. Capital adequacy for regulatory purposes, and the capital category assigned to an institution by its regulators, may be determinative of an institution's overall financial condition.

## C. Results of Operations

### 1. Summary of Performance

#### (a) Summary of Results

For the year ended December 31, 2018, DNB reported net income available to common shareholders of \$10.7 million, an increase of \$2.7 million from \$7.9 million reported for the year ended December 31, 2017, or \$2.48 per diluted share versus \$1.85 per diluted share, respectively.

There are many aspects of the economy and the Federal Reserve's monetary policy that influence DNB's ability to grow revenues and net income. In general, the U.S. economy is growing at a moderate pace. According to the most recent forecast released at the Federal Open Market Committee meeting on December 19, 2018, the U.S. GDP growth will slow to 2.3 percent in 2019 from 3 percent in 2018. The unemployment rate ends the year at 3.7 percent in 2018 and will fall to 3.5 percent in 2019. Inflation was forecast to be 1.9 percent in 2018 and 2019. Employment growth remains robust which, coupled with buoyant asset prices and strong consumer confidence, is sustaining income and consumption growth. Business investment is projected to strengthen as a result of major tax reform and supportive financial conditions. A pick-up in the world economy is underpinning export growth, although tensions have emerged on how best to reduce barriers to trade.

Although the national and international economies influence DNB's results, economic conditions in southeastern Pennsylvania are more germane, as the majority of DNB's loan and deposits relationships are with businesses and individuals within the Third Federal Reserve District. The Federal Reserve's January 16, 2019 Beige Book summarizes the economic climate which impacts DNB's operating environment.

The January 16, 2019 Beige Book indicated that, on balance, aggregate business activity in the Third District maintained a modest pace of growth, although slowing occurred among service sectors and some real estate activity declined. The labor market remains tight, which continued to constrain hiring at a modest pace and to apply moderate upward wage pressures. Price pressures remained modest and eased a bit for service sectors. Nonfinancial services eased back to a modest pace of growth, while manufacturing and non-auto retail sales maintained a modest pace. Auto sales were essentially unchanged, and tourism activity continued to grow slightly. Residential real estate sectors tended to decline, while commercial real estate tended to be flat or down slightly. The growth outlook over the next six months remained positive, with half of the nonmanufacturing firms and over 40 percent of the manufacturers anticipating increases in general activity.

Overall, Third District homebuilders continued to report that activity appears to have fallen modestly. Existing home sales continued to decline moderately across most local markets--hampered by extremely low inventories. However, recent sales and an inventory drawdown have strengthened the Poconos market, which has labored with an excess of foreclosed properties since the Great Recession.

The Federal Reserve's non-residential real estate contacts reported that, on balance, commercial real estate construction continued to decline slightly off high levels. The Federal Reserve's contacts noted ongoing strength in industrial/warehouse properties, except in areas with an insufficient labor supply. While architects and engineers remain busy, the pipeline is thinning for new office, retail, and high-rise residential projects. Contractors are preparing for a slight decline in 2019 activity. Commercial leasing activity has held steady, but analysts note an abundance of caution among market participants.

Third District financial firms continued to report modest growth on a year-over-year basis in credit card lending and in overall loan volumes (excluding credit cards). During the January 16, 2019 Beige Book Period, volumes grew moderately in mortgages, commercial and industrial lending; grew modestly in commercial real estate; and declined somewhat in home equity lines, auto loans, and other consumer loans. The Federal Reserve's contacts continued to cite

strong competition for deposits and quality loans but noted little concern over credit quality deterioration.

During the January 16, 2019 Beige Book Period, Third District manufacturing firms reported that activity continued at a modest pace of growth--typical for the Third District. The percentage of firms that reported increased shipments fell somewhat, while the percentage reporting an increase in new orders edged up. The makers of paper products, primary metal products, and electronic equipment tended to note gains in new orders and shipments; the makers of lumber products, chemicals, fabricated metal products, and industrial equipment reported mixed results. The Federal Reserve's contacts often cited labor supply issues as a deterrent to growth, in addition to supply chain problems, rising commodity prices, and uncertainty surrounding tariffs. Demand for equipment to supply the oil and gas producing sectors has slackened again. On balance, manufacturers continued to expect general activity to increase over the next six months. Expectations of future increases in new orders, shipments, employment, and capital spending remained nearly the same as the December 5, 2018 Beige Book period.

Although DNB's earnings have been impacted by the general economic conditions, the impact has not been as severe as it has been in many parts of the nation, largely due to a relatively healthier economic climate in the Third Federal Reserve District, compared

to other areas of the country. DNB's franchise spans Chester, Philadelphia and Delaware counties in southeastern Pennsylvania and the majority of loans and deposits relationships are with businesses and individuals within the Third Federal Reserve District.

These and other factors have impacted our operations. We continue to focus on the consistency and stability of core earnings and balance sheet strength which are critical success factors in today's challenging economic environment.

(b) Significant Events, Transactions and Economic Changes Affecting Results

Some of DNB's significant events during 2018 include:

- DNB benefited from a reduced federal tax rate during 2018 as a result of the passage of the Tax Cuts and Jobs Act of 2017. Federal tax rates declined from 34% to 21%, effective January 1, 2018. As a result of the rate reduction, DNB was required to re-measure, through income tax expense in the period of enactment, its deferred tax assets and liabilities using the enacted rate at which DNB expects them to be recovered or settled. The re-measurement of the net deferred tax asset resulted in additional income tax expense of \$1.8 million in 2017.
- Significant loan growth of \$89.1 million or 10.5%, contributed to record earnings in 2018 of \$10.7 million, or \$2.48 per diluted share, compared with \$7.9 million, or \$1.85 per diluted share, in 2017. At December 31, 2018, commercial loans, a key strategic emphasis for DNB, totaled \$778.4 million and represented 83.3% of total loans.
- DNB's composite cost of funds increased from 0.73% in 2017, to 1.12% in 2018. Our higher funding cost was precipitated by the Federal Reserve's four quarter-point increases in the FF target rate throughout 2018, coupled with significant competition for available funds in the DNB marketplace.

(c) Trends and Uncertainties

Please refer to Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations-Introductory Overview in this Form 10-K.

(d) Material Changes in Results

Please refer to the discussion above in the section titled "Significant Events, Transactions and Economic Changes Affecting Results."

(e) Effect of Inflation and Changing Rates

For detailed discussion of the effects of inflation and changes in rates on DNB's results, refer to the following discussion on "Net Interest Income."



## 2. Net Interest Income

DNB's earnings performance is primarily dependent upon its level of net interest income, which is the excess of interest income over interest expense. Interest income includes interest earned on loans (net of interest reversals on non-performing loans), investments and Federal funds sold, as well as net loan fee amortization and dividend income. Interest expense includes the interest cost for deposits, FHLBP advances, repurchase agreements, corporate debentures, Federal funds purchased and other borrowings.

During the year ended December 31, 2018, management focused on growing the loan portfolio. Total loans increased \$89.1 million or 10.53% on a year-over year basis. The net interest margin for the year ended December 31, 2018 was 3.45% compared to 3.73% in 2017. The decreased net interest margin was primarily caused by the higher volume and higher cost of interest-bearing liabilities in 2018, over 2017. DNB also recognized purchase accounting accretion and amortization related to the acquisition of ERB which totaled \$1.0 million in additional net interest income, affecting interest income on loans, and interest expense on time deposits and borrowings, compared to \$2.3 million in 2017.

Interest on loans was \$41.9 million for 2018, compared to \$39.3 million for 2017, a \$2.6 million increase. The average balance of loans was \$882.7 million with an average tax equivalent yield, a non-GAAP measure, of 4.75% in 2018, compared to \$819.6 million with an average tax equivalent yield of 4.82% in 2017.

Interest and dividends on investment securities was \$4.1 million for 2018, compared to \$3.9 million for 2017, a \$173,000 increase. The average balance of investment securities was \$175.7 million with an average tax equivalent yield, a non-GAAP measure, of 2.46% in 2018, compared to \$184.2 million with an average tax equivalent yield of 2.39% in 2017.

Interest on deposits was \$7.5 million for 2018, compared to \$4.1 million for 2017, a \$3.4 million increase. The average balance of interest bearing deposits was \$750.6 million with an average rate of 1.00% for 2018, compared to \$698.1 million with an average rate of 0.59% for 2017.

Interest on FHLBP advances was \$887,000 for 2018, compared to \$752,000 for 2017. The average balance on FHLBP advances was \$52.6 million with an average rate of 1.69% for 2018, compared to \$54.1 million with an average rate of 1.39% for 2017.

Interest on other interest bearing accounts was \$528,000 for 2018, compared to \$440,000 for 2017. The average balance on other interest bearing accounts was \$11.5 million with an average rate of 4.60% for 2018 compared to \$9.7 million with an average rate of 4.54% for 2017.

Interest on subordinated debt was \$414,000 for both 2018 and 2017. The average balance on subordinated debt was \$9.8 million with an average rate of 4.25% for both 2018 and 2017.

## 3. Provision for Credit Losses

To provide for known and inherent losses in the loan and lease portfolio, DNB maintains an allowance for credit losses. There was a \$1.2 million provision made in 2018 compared to \$1.7 million in 2017. For a detailed discussion on DNB's reserve methodology, refer to "Item 1 — Determination of the allowance for credit losses" which can be found under "Critical Accounting Policies and Estimates".

#### 4. Non-Interest Income

Non-interest income includes service charges on deposit products; fees received in connection with the sale of non-depository products and services, including fiduciary and investment advisory services offered through DNB First Investment Management and Trust; non-depository securities brokerage products and services and insurance products and services offered through DNB Investments & Insurance; and other sources of income such as increases in the cash surrender value of Bank Owned Life Insurance (“BOLI”), net gains on sales of investment securities and loans. In addition, DNB receives fees for cash management, remote capture, merchant services, debit cards, safe deposit box rentals and similar activities.

Non-interest income was \$5.2 million for 2018 compared to \$5.4 million for 2017. The \$173,000 decrease was primarily due to decreases of \$195,000 in gains from insurance proceeds, \$115,000 in gains on sale of loans, \$104,000 in service charges on deposits (mostly NSF fees and STAR income), \$50,000 in gains on sale of investment securities, \$39,000 in other fees (mostly servicing fee income), and \$7,000 in increase in cash surrender value of BOLI. These decreases were offset by increases of \$242,000 in Wealth Management and \$95,000 in mortgage banking.



## 5. Non-Interest Expense

Non-interest expense includes salaries & employee benefits, furniture & equipment, occupancy, professional & consulting fees as well as marketing, printing & supplies, FDIC insurance, PA shares tax, telecommunications, write-downs on other real estate owned (“OREO”) and other repossessed property and other less significant expense items.

**Salary and employee benefits.** Salary and employee benefits were \$15.5 million for 2018 compared to \$15.2 million for 2017. The \$348,000 increase was primarily attributable to higher level of full-time equivalent employees year over year.

**Furniture and equipment.** Furniture and equipment expense was \$2.2 million for 2018 compared to \$2.1 million for 2017. The \$101,000 increase was mainly attributable to an increase in maintenance agreements.

**Occupancy.** Occupancy expense was \$2.6 million for 2018 compared to \$2.7 million for 2017. The \$50,000 decrease was mainly attributable to a decrease in office building repairs and maintenance.

**Professional and Consulting.** Professional and consulting expense was \$1.7 million for 2018 compared to \$1.9 million for 2017. The \$183,000 decrease was mainly attributable to decreases in consulting expenses of \$117,000 related to high levels of recruitment and placement fees for new employees in 2017, and audit and accounting fees of \$89,000, offset by increases in loan expenses of \$20,000 and legal expenses of \$4,000.

**Loss on sale or write-down of OREO and other repossessed property.** During 2018, DNB had \$171,000 of net loss on the sale/write-downs of OREO properties compared to \$121,000 in 2017. At December 31, 2018, DNB held \$5.1 million of such assets, compared to \$5.0 million at December 31, 2017.

**Due diligence and merger expense.** DNB had no due diligence and merger expense in 2018. Merger and acquisition expenses in connection with the October 1, 2016 acquisition of East River totaled \$77,000 for 2017.

**Other expenses.** Other expenses were \$2.9 million for 2018 compared to \$3.1 million for 2017. The \$236,000 decrease was primarily due to decreases in OREO expenses, officer and employee expenses, and debit card charge-offs.

## 6. Income Taxes

Income tax expense was \$2.3 million and \$5.5 million for the years ended December 31, 2018 and 2017, respectively. The effective tax rates for 2018 and 2017 were 17.65% and 40.71%, respectively. Income tax expense for each period primarily differs from the amount determined at the statutory rate of 21% in 2018 and 34% in 2017 due to tax-exempt income on loans and investment securities, DNB’s ownership of BOLI policies and tax credits recognized on the exercise of stock options and the vesting of restricted shares. The significant increase in the effective tax rate for 2017 was caused by a \$1.8 million charge to adjust deferred taxes, due to the enactment of the Tax Cuts and Jobs Act. This Act reduced corporate income tax rates from 34% to 21%, leading management to revalue its net Deferred Tax Assets, effective as of December 22, 2017. For more information related to income taxes, refer to Note 11 in the Notes to Consolidated Financial Statements.

## D. Financial Condition Analysis

## 1. Investment Securities

DNB's investment portfolio consists of U.S. agency securities, mortgage backed securities and collateralized mortgage obligations issued by U.S. Government agencies, state and municipal securities, bank stocks, and other bonds and notes. In addition to generating revenue, DNB maintains the investment portfolio to manage interest rate risk, provide liquidity, provide collateral for borrowings and to diversify the credit risk of earning assets. The portfolio is structured to maximize DNB's net interest income given changes in the economic environment, liquidity position and balance sheet mix.

Given the nature of the portfolio, and its generally high credit quality, management expects to realize all of its investment upon the maturity of such instruments. Management determines the appropriate classification of securities at the time of purchase. Investment securities are classified as: (a) securities held to maturity ("HTM") based on management's intent and ability to hold them to maturity; (b) trading account ("TA") securities that are bought and held principally for the purpose of selling them in the near term; and (c) securities available for sale ("AFS"). DNB does not currently maintain a trading account portfolio.

Securities classified as AFS include securities that may be sold in response to changes in interest rates, changes in prepayment assumptions, the need to increase regulatory capital or other similar requirements. DNB does not necessarily intend to sell such securities, but has classified them as AFS to provide flexibility to respond to liquidity needs.

DNB's investment portfolio (HTM and AFS securities) totaled \$158.7 million at December 31, 2018, down \$15.5 million or 8.90% from \$174.2 million at December 31, 2017. The \$15.5 million decrease in investment securities was primarily due to \$25.0 million in principal pay-downs, calls and maturities, and a change in unrealized loss of \$350,000, offset by \$10.0 million in purchases.

At December 31, 2018, approximately 61% of DNB's investments were in the AFS portfolio and 39% were in the HTM portfolio. Investments consist mainly of mortgage backed securities and Agency notes backed by government sponsored enterprises, such as FHLMC, FNMA and FHLB. Management regularly reviews its investment portfolio to determine whether any securities are other than temporarily impaired. At December 31, 2018, the combined AFS and HTM portfolios had an unrealized pretax gains of \$184,000 and an unrealized pretax losses of \$3.2 million. At December 31, 2017, the combined AFS and HTM portfolios had an unrealized pretax gain of \$486,000 and an unrealized pretax loss of \$2.2 million. There were no other than temporarily impaired securities.

The following tables set forth information regarding the composition, stated maturity and average yield of DNB's investment security portfolio as of the dates indicated (tax-exempt yields have been adjusted to a tax equivalent basis using a 21% tax rate for 2018 and a 34% tax rate for 2017). The first two tables do not include amortization or anticipated prepayments on mortgage backed securities. Callable securities are included at their stated maturity dates.

#### Investment Maturity Schedule, Including Weighted Average Yield

(Dollars in thousands)

##### December 31, 2018

Held to Maturity	Less than 1 Year	1-5 Years	5-10 Years	Over 10 Years	Total	Yield*
US Government agency obligations	\$ 8,749	\$ -	\$ -	\$ -	\$ 8,749	3.12 %
GSE mortgage-backed securities	-	-	389	-	389	2.86
Corporate bonds	-	5,951	7,900	-	13,851	4.83
Collateralized mortgage obligations GSE	-	-	-	1,159	1,159	2.25
State and municipal taxable	-	362	-	-	362	2.70
State and municipal tax-exempt	2,850	5,402	21,070	8,194	37,516	2.24
Total	\$ 11,599	\$ 11,715	\$ 29,359	\$ 9,353	\$ 62,026	2.95 %
Percent of portfolio	19%	19%	47%	15%	100%	
Weighted average yield	2.85%	3.07%	3.16%	2.24%	2.95%	

Available for Sale	Less than 1 Year	1-5 Years	5-10 Years	Over 10 Years	Total	Yield*
US Government agency obligations	\$ 22,127	\$ 21,857	\$ 3,739	\$ -	\$ 47,723	1.79 %

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GSE mortgage-backed securities	-	1,815	11,307	13,436	26,558	1.99
Collateralized mortgage obligations GSE	-	-	1,162	8,646	9,808	1.81
Corporate bonds	547	9,119	1,038	-	10,704	2.81
State and municipal tax-exempt	-	-	1,134	716	1,850	1.93
Total	\$ 22,674	\$ 32,791	\$ 18,380	\$ 22,798	\$ 96,643	1.96 %
Percent of portfolio	23%	34%	19%	24%	100%	
Weighted average yield	1.17%	2.34%	2.19%	2.01%	1.96%	

\*Non-GAAP tax equivalent yield.

## Composition of Investment Securities

(Dollars in thousands)

	December 31 2018		2017		2016	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Held to Maturity						
US Government agency obligations	\$ 8,749	\$ 8,790	\$ 8,483	\$ 8,646	\$ 8,224	\$ 8,533
GSE mortgage-backed securities	389	389	496	505	1,440	1,478
Corporate bonds	13,851	13,928	14,047	14,288	12,825	12,992
Collateralized mortgage obligations GSE	1,159	1,132	1,471	1,442	1,966	1,946
State and municipal taxable	362	359	363	355	1,008	1,014
State and municipal tax-exempt	37,516	36,537	37,530	37,184	41,559	40,161
Total	\$ 62,026	\$ 61,135	\$ 62,390	\$ 62,420	\$ 67,022	\$ 66,124

	December 31 2018		2017		2016	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Available for Sale						
US Government agency obligations	\$ 48,082	\$ 47,723	\$ 53,279	\$ 52,893	\$ 52,428	\$ 52,309
GSE mortgage-backed securities	27,563	26,558	33,203	32,488	30,861	30,140
Collateralized mortgage obligations GSE	10,249	9,808	12,101	11,654	12,957	12,573
Corporate bonds	10,890	10,704	12,981	12,820	15,474	15,180
State and municipal tax-exempt	1,981	1,850	1,991	1,928	5,084	4,956
Asset-backed security	-	-	-	-	26	26
Total	\$ 98,765	\$ 96,643	\$ 113,555	\$ 111,783	\$ 116,830	\$ 115,184

## 2. Loan and Lease Portfolio

DNB's loan and lease portfolio consists primarily of commercial and residential real estate loans, commercial loans and lines of credit (including commercial construction), commercial leases and consumer loans. The portfolio provides a stable source of interest income, monthly amortization of principal and, in the case of adjustable rate loans, re-pricing opportunities.

Total loans were \$935.0 million at December 31, 2018, up \$89.1 million or 10.53% from 2017. Gross loans funded during 2018 were \$284.5 million, compared to \$263.9 million in 2017. Paydowns on loans were \$195.4 million, down 17.02% from \$235.5 million in 2017. Commercial mortgage loans grew \$50.9 million or 10.49% to \$535.7 million, commercial loans grew by \$38.1 million or 18.62% to \$242.6 million, and residential loans grew \$6.0 million or 6.36% to \$99.9 million. Consumer loans decreased \$5.9 million or 9.36% to \$56.7 million.

The following table sets forth information concerning the composition of total loans outstanding, net of unearned income and fees and the allowance for credit losses, as of the dates indicated.

## Total Loans Outstanding, Net of Allowance for Credit Losses

(Dollars in thousands)

	December 31				
	2018	2017	2016	2015	2014
Residential mortgage	\$ 99,932	\$ 93,959	\$ 87,581	\$ 28,651	\$ 25,993
Commercial mortgage	535,735	484,868	465,486	274,132	257,310
Commercial:					
Commercial term	166,335	129,535	123,175	102,178	80,819
Commercial construction	76,302	75,014	72,755	20,364	35,534
Consumer:					
Home equity	51,536	56,844	62,560	51,270	50,192
Other	5,131	5,677	5,972	5,163	5,755
Total loans	934,971	845,897	817,529	481,758	455,603
Less allowance for credit losses	(6,675)	(5,843)	(5,373)	(4,935)	(4,906)
Net loans	\$ 928,296	\$ 840,054	\$ 812,156	\$ 476,823	\$ 450,697

The following table sets forth information concerning the contractual maturities of the loan portfolio, net of unearned income and fees. For amortizing loans, scheduled repayments for the maturity category in which the payment is due are not reflected below, because such information is not readily available.

### Loan Maturities

(Dollars in thousands)

	December 31, 2018			
	Less than 1 Year	1-5 Years	Over 5 Years	Total
Residential mortgage	\$ 3,824	\$ 4,033	\$ 92,075	\$ 99,932
Commercial mortgage	44,255	133,600	357,880	535,735
Commercial:				
Commercial term	11,906	36,546	117,883	166,335
Commercial construction	35,681	6,214	34,407	76,302
Consumer:				
Home equity	8	3,126	48,402	51,536
Other	93	640	4,398	5,131
Total loans	95,767	184,159	655,045	934,971
Loans with fixed interest rates	38,563	137,521	297,057	473,141
Loans with variable interest rates	57,204	46,638	357,988	461,830
Total loans	\$ 95,767	\$ 184,159	\$ 655,045	\$ 934,971

### 3. Non-Performing Assets

Total non-performing assets decreased \$1.7 million to \$10.8 million at December 31, 2018, compared to \$12.6 million at December 31, 2017. The \$1.7 million decrease was attributable to a \$2.0 million decrease in non-accrual loans offset by a \$39,000 increase in other real estate owned & other repossessed property and a \$179,000 increase in loans 90 days past due and still accruing. As a result of the decrease in non-performing loans and an \$89.1 million net increase in gross loans, the non-performing loans to total loans ratio decreased to 0.61% at December 31, 2018, from 0.89% at December 31, 2017. The non-performing assets to total assets ratio decreased to 0.94% at December 31, 2018 from 1.16% at December 31, 2017. The allowance to non-performing loans ratio increased to 115.50% at December 31, 2018 from 77.36% at December 31, 2017. DNB continues to work diligently to improve asset quality by adhering to strict underwriting standards and improving lending policies and procedures. Non-performing assets have had, and will continue to have, an impact on earnings; therefore management intends to continue working aggressively to reduce the level of such assets.

Non-performing assets are comprised of non-accrual loans, loans delinquent over ninety days and still accruing, as well as OREO and other repossessed assets. Non-accrual loans are loans for which the accrual of interest ceases when the collection of principal or interest payments is determined to be doubtful by management. It is the policy of DNB to discontinue the accrual of interest when principal or interest payments are delinquent 90 days or more (unless the loan principal and interest are determined by management to be fully secured and in the process of collection), or earlier if considered prudent. Interest received on such loans is applied to the principal balance, or may, in some instances, be recognized as income on a cash basis. A non-accrual loan or lease may be restored to accrual status when management expects to collect all contractual principal and interest due and the borrower has demonstrated a sustained period of repayment performance in accordance with the contractual terms. OREO consists of real estate acquired by foreclosure or deed-in-lieu of foreclosure. Other repossessed assets are primarily assets from DNB's commercial lease

portfolio that were repossessed. OREO and other repossessed assets are carried at the lower of carrying value or estimated fair value, less estimated disposition costs. Any significant change in the level of non-performing assets is dependent, to a large extent, on the economic climate within DNB's market area.

DNB's Credit Policy Committee monitors the performance of the loan and lease portfolio to identify potential problem assets on a timely basis. Committee members meet to design, implement and review asset recovery strategies, which serve to maximize the recovery of each troubled asset. Of the \$12.4 million loans classified as substandard as of December 31, 2018, \$6.3 million are performing and are believed to require increased supervision and review; and may, depending on the economic environment and other factors, become non-performing assets in future periods. The majority of these loans are secured by commercial real estate, with lesser amounts being secured by residential real estate, inventory and receivables. The amount of performing substandard loans at December 31, 2017 was \$4.5 million.



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The following table sets forth those assets that are: (i) placed on non-accrual status, (ii) contractually delinquent by 90 days or more and still accruing, and (iii) OREO as a result of foreclosure or voluntary transfer to DNB as well as other repossessed assets. In addition, the table sets forth DNB's asset quality and allowance coverage ratios at the dates indicated:

Non-Performing Assets

(Dollars in thousands)

	December 31				
	2018	2017	2016	2015	2014
Non-accrual loans:					
Residential mortgage	\$ 905	\$ 1,915	\$ 1,770	\$ 1,619	\$ 2,457
Commercial mortgage	1,307	2,259	4,593	1,048	1,294
Commercial:					
Commercial term	2,300	2,100	198	188	198
Commercial construction	476	514	1,242	1,028	2,043
Consumer:					
Home equity	391	466	442	563	432
Other	167	245	256	189	95
Total non-accrual loans	5,546	7,499	8,501	4,635	6,519
Loans 90 days past due and still accruing	233	54	-	457	334
Total non-performing loans	5,779	7,553	8,501	5,092	6,853
Other real estate owned & other repossessed property	5,051	5,012	2,767	2,581	901
Total non-performing assets	\$ 10,830	\$ 12,565	\$ 11,268	\$ 7,673	\$ 7,754
Asset quality ratios:					
Non-performing loans to total loans	0.62 %	0.89 %	1.04 %	1.06 %	1.50 %
Non-performing assets to total assets	0.94	1.16	1.05	1.02	1.07
Allowance for credit losses to:					
Total loans	0.71	0.69	0.66	1.02	1.08
Non-performing loans	115.50	77.36	63.20	96.91	71.59
If contractual interest income had been recorded on non-accrual loans, interest would have been increased as shown in the following tables:					

Non-accrual Loans – Contractual Interest Income

(Dollars in thousands)

Year Ended December  
31, 2018

	December 31, 2018	Interest income that would have been recorded under original terms	Interest income recorded during the period	Net impact on interest income
Non-accrual loans:				
Residential mortgage	\$ 905	\$ 50	\$ -	\$ 50
Commercial mortgage	1,307	103	-	103
Commercial:				
Commercial term	2,300	178	-	178
Commercial construction	476	36	-	36
Consumer:				
Home equity	391	21	-	21
Other	167	14	-	14
Total non-accrual loans	5,546	402	-	402
Loans 90 days past due and still accruing	233	4	4	-
Total non-performing loans	\$ 5,779	\$ 406	\$ 4	\$ 402

	Year Ended December 31, 2017	Interest income that would have been recorded under original terms	Interest income recorded during the period	Net impact on interest income
Non-accrual loans:				
Residential mortgage	\$ 1,915	\$ 76	\$ -	\$ 76
Commercial mortgage	2,259	181	-	181
Commercial:				
Commercial term	2,100	137	-	137
Commercial construction	514	149	-	149
Consumer:				
Home equity	466	22	-	22
Other	245	24	-	24
Total non-accrual loans	7,499	589	-	589
Loans 90 days past due and still accruing	54	2	2	-
Total non-performing loans	\$ 7,553	\$ 591	\$ 2	\$ 589



#### 4. Allowance for Credit Losses

To provide for known and inherent losses in the loan and lease portfolios, DNB maintains an allowance for credit losses. Provisions for credit losses are charged against income to increase the allowance when necessary. Loan and lease losses are charged directly against the allowance and recoveries on previously charged-off loans are added to the allowance. In establishing its allowance for credit losses, management considers the size and risk exposure of each segment of the loan and lease portfolio, past loss experience, present indicators of risk such as delinquency rates, levels of non-accruals, the potential for losses in future periods, and other relevant factors. Management's evaluation of criticized and classified loans generally includes reviews of borrowers of \$100,000 or greater. Consideration is also given to examinations performed by regulatory agencies, primarily the OCC.

Management reviews and establishes the adequacy of the allowance for credit losses in accordance with U.S. generally accepted accounting principles, guidance provided by the Securities and Exchange Commission and as prescribed in OCC Bulletin 2006-47. Its methodology for assessing the appropriateness of the allowance consists of several key elements which include: specific allowances for identified impaired loans; and allowances by loan type for pooled homogenous loans. In considering national and local economic trends, we review a variety of information including Federal Reserve publications, general economic statistics, foreclosure rates and housing statistics published by third parties. We believe this improves the measure of inherent loss over a complete economic cycle and reduces the impact for qualitative adjustments. An unallocated portion of the allowance is intended to provide for probable losses not otherwise accounted for in management's other elements of its overall estimate. An unallocated component is maintained to cover uncertainties such as changes in the national and local economy, concentrations of credit, expansion into new markets and other factors that could affect management's estimate of probable losses. The unallocated component of the allowance also reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

In addition, DNB reviews historical loss experience for the commercial real estate, commercial, residential real estate, home equity and consumer installment loan pools to determine historical loss factors. The historical loss factors are then applied to the current portfolio balances to determine the required reserve percentage for each loan pool based on risk rating. Historical losses are segregated into risk-similar groups and a loss ratio is determined for each group over a five year period. The five year average loss ratio by type is then used to calculate the estimated loss based on the current balance of each group. This five year time period is appropriate given DNB's historical level of losses and, more importantly, represents the current economic environment.

This analysis is intended to assess the potential for loss within the loan portfolio and to substantiate the adequacy of the allowance. Should the analysis indicate that the allowance is not adequate, management will recommend a provision expense be made in an amount equal to the shortfall derived. In establishing and reviewing the allowance for adequacy, emphasis has been placed on utilizing the methodology prescribed in OCC Bulletin 2006-47. Management believes that the following factors create a comprehensive system of controls in which management can monitor the quality of the loan portfolio. Consideration has been given to the following factors and variables which may influence the risk of loss within the loan portfolio:

- Changes in the nature and volume of the portfolio and in the terms of loans
- Changes in the volume and severity of past due loans, the volume of non-accrual loans, and the volume and severity of adversely classified or graded loans
- The existence and effect of any concentrations of credit, and changes in the level of such concentrations
- Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses
- Changes in the experience, ability, and depth of lending management and other relevant staff
- Changes in the Loan Review Methodology and Degree of Oversight by Bank's Board of Directors.
- Changes in international, national, regional, and local economic and business conditions and developments that affect the collectability of the portfolio, including the condition of various market segments

- The effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the institution's existing portfolio
- Changes in the value of underlying collateral for collateral dependent loans

Portfolio risk includes the levels and trends in delinquencies, impaired loans, changes in the loan rating matrix and trends in volume and terms of loans. Management is satisfied with the stability of the past due and non-performing loans and believes there has been no decline in the quality of the loan portfolio due to any trend in delinquent or adversely classified loans. In determining the adequacy of the allowance, management considers any deterioration of asset quality in DNB's commercial mortgage and residential first mortgage portfolios. New appraisal values we have obtained for existing loans have generally been consistent with trends indicated by Case-Schiller and other indices.

DNB closely monitors the loan to value ratios of all classified assets and requires periodic current appraisals to monitor underlying collateral values. Management also reviews borrower, sponsorship and guarantor's financial strength along with their ability and willingness to provide financial support of their obligations on an immediate and continuing basis.

The provision for credit losses decreased to \$1.2 million in 2018, compared to \$1.7 million in 2017. DNB's percentage of allowance for credit losses to total loans was 0.71% at December 31, 2018 compared to 0.69% as of December 31, 2017. Loans acquired in connection with the purchase of ERB in 2016 have been recorded at fair value, in accordance with GAAP, and are based on an initial estimate of the expected cash flows, including a reduction for estimated credit losses, and without carryover of the respective portfolio's historical allowance for credit losses. DNB will continually evaluate the loans acquired from ERB for additional impairment as part of our normal allowance review process. Net charge-offs were \$368,000 in 2018, compared to \$1.2 million in 2017. The percentage of net charge-offs to total average loans was 0.04% in 2018, compared to 0.15% in 2017. Management is not aware of any potential problem loans, which were accruing and current at December 31, 2018, where serious doubt exists as to the ability of the borrower to comply with the present repayment terms and that would result in a significant loss to DNB.

We typically establish a general valuation allowance on classified loans which are not impaired. In establishing the general valuation allowance, we segregate these loans by loan type. For commercial and construction loans, the determination of the category for each loan is based on periodic reviews of each loan by our lending and credit officers as well as an independent, third party consultant. The reviews include a consideration of such factors as recent payment history, current financial data, cash flow, financial projections, collateral evaluations, guarantor or sponsorship financial strength and current economic and business conditions. Categories for mortgage and consumer loans are determined through a similar review. Classification of a loan within a category is based on identified weaknesses that increase the credit risk of loss on the loan. The allowance percentage, is determined based on inherent losses associated with each type of lending as determined through consideration of our loss history with each type of loan, trends in credit quality and collateral values, and an evaluation of current economic and business conditions.

We establish a general allowance on non-classified loans to recognize the inherent losses associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem loans. This general valuation allowance is determined by segregating the loans by loan category and assigning allowance percentages to each category. An evaluation of each category is made to determine the need to further segregate the loans within each category by type. For our residential mortgage and consumer loan portfolios, we treat them as homogeneous pools. For our commercial real estate and construction loan portfolios, a further analysis is made in which we segregated the loans by type based on the purpose of the loan and the collateral properties securing the loan. Various risk factors for each type of loan are considered, including the impact of general economic and business conditions, collateral value trends, credit quality trends and historical loss experience.

As of December 31, 2018, DNB had \$10.8 million of non-performing assets, which included \$5.8 million of non-performing loans and \$5.1 million of OREO and other repossessed property. Loans are reviewed for impairment in accordance with FASB ASC 310-10-35. Impaired loans can either be secured or unsecured, not including large groups of smaller balance loans that are collectively evaluated. Impairment is measured by the difference between the loan amount and the present value of the future cash flow discounted at the loan's effective interest rate. Management measures loans for impairment by using the fair value of collateral for collateral dependent loans. In general, management reduces the amount of the appraisal by the estimated cost of acquisition and disposition of the underlying collateral and compares that adjusted value with DNB's carrying value. DNB establishes a specific valuation allowance on impaired loans that have a collateral shortfall, including estimated costs to sell in comparison to the carrying value of the loan. Of the \$7.8 million of impaired loans (\$5.5 million of non-performing loans, \$1.8 million of performing TDRs, and a \$514,000 performing ASC 310-30 loan) at December 31, 2018, \$1.8 million had a valuation allowance of \$285,000 and \$6.0 million had no specific allowance. For those impaired loans that management determined that no specific valuation allowance was necessary, management has reviewed the appraisal for each loan and determined that there is no shortfall in the collateral. During the year ended December 31, 2018, DNB recognized \$742,000 in total charge-offs, \$685,000 of which related to impaired loans.

We typically order new third party appraisals or collateral valuations when a loan becomes impaired or is transferred to OREO. This is done within two weeks of a loan becoming impaired or a loan moving to OREO. It generally takes two to eight weeks to receive the appraisals, depending on the type of property being appraised. We recognize any

provision or related charge-off within two weeks of receiving the appraisal after the appraisal has been reviewed by DNB. We generally order a new appraisal for all impaired real estate loans having a balance of \$100,000 or higher, every twelve months, unless management determines more frequent appraisals are necessary. We use updated valuations when time constraints do not permit a full appraisal process, to reflect rapidly changing market conditions. Because appraisals and updated valuations utilize historical data in reaching valuation conclusions, the appraised or updated value may or may not reflect the actual sales price that we will receive at the time of sale.

Real estate appraisals typically include up to three approaches to value: the sales comparison approach, the income approach (for income producing property) and the cost approach. Not all appraisals utilize all three approaches to value. Depending on the nature of the collateral and market conditions, the appraiser may emphasize one approach over another in determining the fair value of collateral.

Appraisals may also contain different estimates of value based on the level of occupancy or future improvements. “As-is” valuations represent an estimate of value based on current market conditions with no changes to the collateral’s use or condition. “As-stabilized” or “as-completed” valuations assume that the collateral is improved to a stated standard or achieves its highest and best use in terms of occupancy. “As-stabilized” valuations may be subject to a present value adjustment for market conditions or the schedule for improvements.

In connection with the valuation process, we will typically develop an exit strategy for the collateral by assessing overall market conditions, the current condition and use of the asset and its highest and best use. For most income producing real estate, investors value most highly a stable income stream from the asset; consequently, we conduct a comparative evaluation to determine whether conducting a sale on an “as-is” basis or on an “as-stabilized” basis is most likely to produce the highest net realizable value and compare these values with the costs incurred and the holding period necessary to achieve the “as stabilized” value.

Our estimates of the net realizable value of collateral include a deduction for the expected costs to sell the collateral or such other deductions as deemed appropriate. For most real estate collateral, we apply a seven to ten percent deduction to the value of real estate collateral to determine its expected costs to sell the asset. This estimate generally includes real estate commissions, one year of real estate taxes and miscellaneous repair and closing costs. If we receive a purchase offer that requires unbudgeted repairs, or if the expected holding period for the asset exceeds one year, then we include the additional real estate taxes and repairs or other holding costs in the expected costs to sell the collateral on a case-by-case basis.

#### Analysis of Allowance for Credit Losses

(Dollars in thousands)

	Year Ended December 31				
	2018	2017	2016	2015	2014
Beginning balance	\$ 5,843	\$ 5,373	\$ 4,935	\$ 4,906	\$ 4,623
Provisions	1,200	1,660	730	1,105	1,130
Loans charged off:					
Residential mortgage	(178)	(85)	(206)	(194)	(326)
Commercial mortgage	(249)	(519)	(39)	(105)	(8)
Commercial:					
Commercial term	(243)	(683)	(45)	(200)	(47)
Commercial construction	-	-	-	(581)	(511)
Lease financing	-	-	-	-	(1)
Consumer:					
Home equity	-	-	-	(11)	-
Other	(72)	(38)	(21)	(63)	(82)
Total charged off	(742)	(1,325)	(311)	(1,154)	(975)
Recoveries:					
Residential mortgage	341	16	13	4	5
Commercial mortgage	22	51	-	-	-
Commercial:					
Commercial term	4	23	1	13	3
Commercial construction	5	42	1	10	103
Lease financing	-	1	3	49	8
Consumer:					
Home equity	-	-	-	-	-
Other	2	2	1	2	9
Total recoveries	374	135	19	78	128
Net charge-offs	(368)	(1,190)	(292)	(1,076)	(847)
Ending balance	\$ 6,675	\$ 5,843	\$ 5,373	\$ 4,935	\$ 4,906



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Reserve for unfunded loan commitments	\$ 395		\$ 348		\$ 345		\$ 188		\$ 166	
Ratio of net charge-offs to average loans	0.04	%	0.15	%	0.05	%	0.23	%	0.19	%

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The following table sets forth the composition of DNB's allowance for credit losses at the dates indicated.

### Composition of Allowance for Credit Losses

(Dollars in thousands)

December 31

	2018			2017			2016			2015			2014		
	Percent of Loan Type to Total			Percent of Loan Type to Total			Percent of Loan Type to Total			Percent of Loan Type to Total			Percent of Loan Type to Total		
	Amount	Loans		Amount	Loans		Amount	Loans		Amount	Loans		Amount	Loans	
Residential mortgage	\$ 161	11	%	\$ 221	11	%	\$ 349	11	%	\$ 216	6	%	\$ 269	6	%
Commercial mortgage	3,647	57		2,856	57		2,531	57		2,375	57		2,300	56	
Commercial:															
Commercial term	1,062	18		845	15		709	15		989	21		709	18	
Commercial construction	1,032	8		1,128	9		969	9		569	4		881	8	
Consumer:															
Home equity	190	5		183	7		196	7		195	11		189	11	
Other	46	1		63	1		61	1		64	1		70	1	
Unallocated	537	-		547	-		558	-		527	-		488	-	
Total	\$ 6,675	100	%	\$ 5,843	100	%	\$ 5,373	100	%	\$ 4,935	100	%	\$ 4,906	100	%
Reserve for unfunded loan commitments (other liability)	\$ 395			\$ 348			\$ 345			\$ 188			\$ 166		

### 5. Certain Regulatory Matters

Dividends payable to DNB by the Bank are subject to certain regulatory limitations. Under normal circumstances, the payment of dividends in any year without regulatory permission is limited to the net profits (as defined for regulatory purposes) for that year, plus the retained net profits for the preceding two calendar years. The sum of these items amounted to \$15.2 million for the year ended December 31, 2018.

The FDIC has authority to assess and change federal deposit insurance assessment rates based on average consolidated assets, less tangible equity capital of the Bank. For further information, please refer to the discussion of FDIC deposit insurance assessments under Part I, Item 1 ("Business"), section (c) ("Narrative Description of Business") — "Supervision and Regulation — Bank" under the heading "FDIC Insurance and Assessments" in this report. DNB's FDIC insurance expense was \$479,000 in 2018 and \$602,000 in 2017.

DNB met all regulatory capital requirements at December 31, 2018. Please refer to Note 17 to the Consolidated Financial Statements for a table that summarizes required capital ratios and the corresponding regulatory capital positions of DNB and the Bank at December 31, 2018 and 2017.

At December 31, 2018, DNB owned \$3.1 million of Federal Home Loan Bank of Pittsburgh ("FHLBP") stock, \$2.3 million of Federal Reserve Bank ("FRB") stock, and \$156,000 of Atlantic Community Bankers Bank ("ACBB") stock, compared to \$5.2 million, \$2.3 million, and \$156,000, respectively, at December 31, 2017. Total restricted stock was

\$5.6 million at December 31, 2018 compared to \$7.6 million at December 31, 2017. DNB had outstanding borrowings of \$32.9 million and outstanding letters of credit of \$30.0 million from the FHLBP at December 31, 2018 compared to \$79.0 million and \$65.0 million, respectively, at December 31, 2017. DNB recognized dividend income of \$280,000 on FHLBP stock, \$139,000 on FRB stock, and \$6,000 in ACBB stock in 2018, compared to \$197,000, \$119,000, and \$0 in 2017. DNB's excess borrowing capacity from the FHLBP was \$508.6 million at December 31, 2018, compared to \$456.9 million at December 31, 2017.

#### 6. Off Balance Sheet Arrangements

In the normal course of business, various commitments and contingent liabilities are outstanding, such as guarantees and commitments to extend credit, borrow money or act in a fiduciary capacity, which are not reflected in the consolidated financial statements. Management does not anticipate any significant losses as a result of these commitments.

DNB had outstanding stand-by letters of credit totaling \$2.3 million and unfunded loan and lines of credit commitments totaling \$190.8 million at December 31, 2018. DNB had outstanding stand-by letters of credit totaling \$4.6 million and unfunded loan and lines of credit commitments totaling \$176.6 million at December 31, 2017.

These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet. The exposure to credit loss, in the event of non-performance by the party to the financial instrument for commitments to extend credit and stand-by letters of credit, is represented by the contractual amount. Management uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. DNB evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral, if any, obtained upon the extension of credit, usually consists of real estate, but may include securities, property or other assets.

Stand-by letters of credit are conditional commitments issued by DNB to guarantee the performance or repayment of a financial obligation of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risks involved in issuing letters of credit are essentially the same as those involved in extending loan facilities to customers. DNB holds various forms of collateral to support these commitments.

DNB maintains borrowing arrangements with various correspondent banks, the FHLBP and the Federal Reserve Bank of Philadelphia to meet short-term liquidity needs. Through these relationships, DNB had available credit of approximately \$568.6 million and \$516.9 million at December 31, 2018 and December 31, 2017, respectively. At December 31, 2018, DNB had \$32.9 million of FHLBP borrowings outstanding and the FHLBP had issued letters of credit, on DNB's behalf, totaling \$30.0 million against its available credit lines. At December 31, 2017, DNB had \$79.0 million of FHLBP borrowings outstanding and the FHLBP had issued letters of credit, on DNB's behalf, totaling \$65.0 million against its available credit lines.

As of December 31, 2018, approximately \$253.3 million of assets are held by DNB First Wealth Management in a fiduciary, custody or agency capacity. The amount of these assets at December 31, 2017 was \$252.8 million. These assets are not assets of DNB, and are not included in the consolidated financial statements.

## Off Balance Sheet Obligations

(Dollars in thousands)

	Expiration by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Commitments to extend credit	\$ 190,770	\$ 28,557	\$ 17,941	\$ 840	\$ 143,432
Stand-by letters of credit	2,335	1,824	161	-	350
Total	\$ 193,105	\$ 30,381	\$ 18,102	\$ 840	\$ 143,782

For detailed information regarding FHLBP Advances and Short Term Borrowed Funds, see Note 7 to the Consolidated Financial Statements.

The following table sets forth DNB's known contractual obligations as of December 31, 2018.

## Contractual Obligations

(Dollars in thousands)

	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
FHLBP advances	\$ 32,935	\$ 14,592	\$ 11,343	\$ 7,000	\$ -
Interest on FHLBP advances	1,165	630	452	83	-
Time deposits	162,096	97,071	56,812	8,213	-
Interest on time deposits	3,792	2,551	930	311	-
Brokered time deposits	98,639	45,511	48,128	5,000	-
Interest on brokered time deposits	2,570	1,623	900	47	-
Capital lease obligations	305	69	170	66	-
Interest on capital lease obligations	83	37	43	3	-
Operating lease obligations	3,148	1,047	1,432	669	-
Long-term subordinated debt	9,750	-	-	-	9,750
Interest on long-term subordinated debt	3,008	414	579	1,268	747
Junior subordinated debentures	9,279	-	-	-	9,279
Interest on junior subordinated debentures	7,123	511	1,025	1,024	4,563
SERPs	3,698	44	88	107	3,459
Total	\$ 337,591	\$ 164,100	\$ 121,902	\$ 23,791	\$ 27,798

## Item 7A. Quantitative and Qualitative Disclosures About Market Risk

To measure the impacts of longer-term asset and liability mismatches beyond two years, DNB utilizes an Economic Value of Equity (“EVE”) model. The EVE model measures the potential price risk of equity to changes in interest rates and factors in the optionality included on the balance sheet. EVE analysis is used to dynamically model the present value of asset and liability cash flows, with rates ranging up or down 200 basis points. The EVE is likely to be different if rates change. Results falling outside prescribed ranges may require action by management. At December 31, 2018 and 2017, DNB’s variance in the EVE as a percentage of assets with an instantaneous and sustained parallel shift of 200 basis points was within its negative 3% guideline, as shown in the following table. The change as a percentage of the present value of equity with a 200 basis point increase was within DNB’s negative 25% guideline at December 31, 2018 and 2017.

## Quantitative and Qualitative Disclosures About Market Risk

(Dollars in thousands)

	December 31, 2018			December 31, 2017		
	Flat	–200bp	+200bp	Flat	–200bp	+200bp
Change in rates						
EVE	\$ 153,190	\$ 148,270	\$ 145,420	\$ 129,535	\$ 120,945	\$ 123,710
Change		(4,920)	(7,770)		(8,590)	(5,825)
Change as a % of assets		(0.4) %	(0.7) %		(0.8) %	(0.5) %
Change as a % of PV equity		(3.2) %	(5.1) %		(6.6) %	(4.5) %

## Item 8. Financial Statements and Supplementary Data

## DNB FINANCIAL CORPORATION AND SUBSIDIARIES

## Consolidated Statements of Financial Condition

(Dollars in thousands, except share data)

	December 31	
	2018	2017
Assets		
Cash and due from banks	\$ 17,321	\$ 10,917
Cash and cash equivalents	17,321	10,917
Available-for-sale investment securities at fair value (amortized cost of \$98,765 and \$113,555)	96,643	111,783
Held-to-maturity investment securities (fair value of \$61,135 and \$62,420)	62,026	62,390
Total investment securities	158,669	174,173
Loans held for sale	419	651
Loans	934,971	845,897
Allowance for credit losses	(6,675)	(5,843)
Net loans	928,296	840,054
Restricted stock	5,616	7,641
Office property and equipment, net	7,636	8,649
Accrued interest receivable	4,207	3,822
Other real estate owned & other repossessed property	5,051	5,012
Bank owned life insurance (BOLI)	9,530	9,314
Core deposit intangible	343	435
Goodwill	15,525	15,525
Net deferred taxes	2,762	2,980
Other assets	2,860	2,742
Total assets	\$ 1,158,235	\$ 1,081,915
Liabilities and Stockholders' Equity		
Liabilities		
Non-interest-bearing deposits	\$ 164,746	\$ 176,815
Interest-bearing deposits:		
NOW	236,071	199,310
Money market	235,023	221,726
Savings	77,979	81,050
Time	162,096	140,490
Brokered deposits	108,651	41,812
Total deposits	984,566	861,203
Federal Home Loan Bank of Pittsburgh (FHLBP) advances	32,935	79,013
Repurchase agreements	-	12,023
Junior subordinated debentures	9,279	9,279
Subordinated debt	9,750	9,750
Other borrowings	3,305	2,738
Total borrowings	55,269	112,803

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Accrued interest payable	646	554
Other liabilities	5,908	5,413
Total liabilities	1,046,389	979,973
Commitments and contingencies	-	-
Stockholders' Equity		
Common stock, \$1.00 par value; 20,000,000 shares authorized; 4,381,872 and 4,362,939 issued, respectively; 4,321,745 and 4,286,117 outstanding, respectively	4,391	4,379
Treasury stock, at cost; 60,127 and 76,822 shares, respectively	(1,130)	(1,429)
Surplus	69,333	69,110
Retained earnings	42,223	32,272
Accumulated other comprehensive loss, net	(2,971)	(2,390)
Total stockholders' equity	111,846	101,942
Total liabilities and stockholders' equity	\$ 1,158,235	\$ 1,081,915
See accompanying notes to consolidated financial statements.		



## DNB FINANCIAL CORPORATION AND SUBSIDIARIES

## Consolidated Statements of Income

(Dollars in thousands, except share and per share data)

	Year Ended December 31	
	2018	2017
Interest and Dividend Income:		
Interest and fees on loans	\$ 41,851	\$ 39,254
Interest and dividends on investment securities:		
Taxable	3,220	2,983
Exempt from federal taxes	874	938
Interest on cash and cash equivalents	230	210
Total interest and dividend income	46,175	43,385
Interest Expense:		
Interest on NOW, money market and savings	3,862	2,289
Interest on time deposits	1,982	1,257
Interest on brokered deposits	1,662	538
Interest on FHLBP advances	887	752
Interest on repurchase agreements	15	28
Interest on junior subordinated debentures	465	386
Interest on subordinated debt	414	414
Interest on other borrowings	84	56
Total interest expense	9,371	5,720
Net interest income	36,804	37,665
Provision for credit losses	1,200	1,660
Net interest income after provision for credit losses	35,604	36,005
Non-interest Income:		
Service charges	1,119	1,223
Wealth management	1,955	1,713
Mortgage banking, net	243	148
Increase in cash surrender value of BOLI	216	223
Gains on sale of investment securities, net	-	50
Gains on sale of loans	38	153
Gain from insurance proceeds	8	203
Other fees	1,666	1,705
Total non-interest income	5,245	5,418
Non-interest Expense:		
Salaries and employee benefits	15,552	15,204
Furniture and equipment	2,166	2,065
Occupancy	2,629	2,679
Professional and consulting	1,739	1,922
Advertising and marketing	711	755
Printing and supplies	212	231
FDIC insurance	479	602
PA shares tax	965	867
Telecommunications	339	350

Loss on sale or write down of OREO, net	171	121
Due diligence and merger expense	-	77
Other expenses	2,912	3,148
Total non-interest expense	27,875	28,021
Income before income tax expense	12,974	13,402
Income tax expense	2,290	5,456
Net income	10,684	7,946
Earnings per common share:		
Basic	\$ 2.48	\$ 1.87
Diluted	\$ 2.48	\$ 1.85
Cash dividends per common share	\$ 0.28	\$ 0.28
Weighted average common shares outstanding:		
Basic	4,303,410	4,260,137
Diluted	4,315,324	4,290,070
See accompanying notes to consolidated financial statements.		

## DNB FINANCIAL CORPORATION AND SUBSIDIARIES

## Consolidated Statements of Comprehensive Income

(Dollars in thousands)

	Year Ended December 31	
	2018	2017
Net income	\$ 10,684	\$ 7,946
Other Comprehensive Income (Loss):		
Unrealized holding losses on AFS investment securities arising during the period		
Before tax amount	(350)	(117)
Tax effect	73	40
	(277)	(77)
Accretion of discount on AFS to HTM reclassification		
Before tax amount(1)	-	8
Tax effect(2)	-	(3)
	-	5
Less reclassification for gains on sales of AFS investment securities included in net income		
Before tax amount(3)	-	(9)
Tax effect(2)	-	3
	-	(6)
Other comprehensive loss - securities	(277)	(78)
Unrealized actuarial gains (losses) - pension		
Before tax amount	212	(57)
Tax effect	(45)	19
	167	(38)
Total other comprehensive loss	(110)	(116)
Total comprehensive income	\$ 10,574	\$ 7,830

(1) Amounts are included in "Interest and dividends on investment securities" in the consolidated statements of income.

(2) Amounts are included in "Income tax expense" in the consolidated statements of income.

(3) Amounts are included in "Gains on sale of investment securities, net" in the consolidated statements of income.

See accompanying notes to consolidated financial statements.

## DNB FINANCIAL CORPORATION AND SUBSIDIARIES

## Consolidated Statements of Changes in Stockholders' Equity

(Dollars in thousands)

	Common Stock	Treasury Stock	Surplus	Retained Earnings	Accumulated Other Compre- hensive Loss	Total
Balance at January 1, 2017	\$ 4,351	\$ (1,730)	\$ 68,973	\$ 25,520	\$ (2,274)	\$ 94,840
Net income	-	-	-	7,946	-	7,946
Other comprehensive loss	-	-	-	-	(116)	(116)
Restricted stock compensation expense (13,839 shares vested)	24	-	535	-	-	559
Exercise of stock options (14,748 shares)	15	-	(15)	-	-	-
Shares withheld for employee taxes on stock option exercise and share award vest	(11)	-	(624)	-	-	(635)
Cash dividends - common (\$0.28 per share)	-	-	-	(1,194)	-	(1,194)
Sale of treasury shares to 401(k) (10,928 shares)	-	197	155	-	-	352
Sale of treasury shares to deferred comp. plan (5,824 shares)	-	104	86	-	-	190
Balance at December 31, 2017	4,379	(1,429)	69,110	32,272	(2,390)	101,942
Net income	-	-	-	10,684	-	10,684
Other comprehensive loss	-	-	-	-	(110)	(110)
Restricted stock compensation expense (11,135 shares vested)	11	-	304	-	-	315
Exercise of stock options (7,798 shares)	8	-	(8)	-	-	-
Shares withheld for employee taxes on stock option exercise and share award vest	(7)	-	(358)	-	-	(365)
Cash dividends - common (\$0.28 per share)	-	-	-	(1,204)	-	(1,204)
Sale of treasury shares to 401(k) (11,232 shares)	-	202	191	-	-	393
Sale of treasury shares to deferred comp. plan (5,463 shares)	-	97	94	-	-	191
Adoption impact - ASU 2018-02	-	-	-	471	(471)	-
Balance at December 31, 2018	\$ 4,391	\$ (1,130)	\$ 69,333	\$ 42,223	\$ (2,971)	\$ 111,846

See accompanying notes to consolidated financial statements.

## DNB FINANCIAL CORPORATION AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

(Dollars in thousands)

	Year Ended December 31 2018	2017
Cash Flows From Operating Activities:		
Net income	\$ 10,684	\$ 7,946
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	1,499	1,649
Provision for credit losses	1,200	1,660
Stock based compensation	315	559
Non-cash funding of retirement plans	584	542
Net gain on sale of securities	-	(50)
Net loss on sale and write down of OREO and other repossessed property	171	121
Gain on insurance proceeds	(8)	(203)
Earnings from investment in BOLI	(216)	(223)
Deferred tax expense	247	2,329
Proceeds from sales of mortgage loans	14,170	5,710
Mortgage loans originated for sale	(13,695)	(6,213)
Gain on sale of mortgage loans	(243)	(148)
Proceeds from sales of loans	806	2,403
Loans originated for sale	(768)	(2,250)
Gain on sale of loans	(38)	(153)
Increase in accrued interest receivable	(385)	(255)
Increase in other assets	(118)	(405)
Increase in accrued interest payable	92	20
Increase in other liabilities	706	1,899
Net Cash Provided By Operating Activities	15,003	14,938
Cash Flows From Investing Activities:		
Activity in available-for-sale securities:		
Sales	-	3,030

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Maturities, repayments and calls	24,490	30,201
Purchases	(10,000)	(30,352)
Activity in held-to-maturity securities:		
Sales	-	737
Maturities, repayments and calls	489	5,442
Purchases	-	(1,407)
Net decrease (increase) in restricted stock	2,025	(2,260)
Net increase in loans	(86,914)	(32,453)
Death benefit proceeds	8	664
Purchases of office property and equipment	(219)	(642)
Expenses capitalized in OREO	-	(15)
Proceeds from sale of OREO and other repossessed property	262	609
Net Cash Used in Investing Activities	(69,859)	(26,446)
Cash Flows From Financing Activities:		
Net increase (decrease) in deposits	123,363	(23,984)
Repayment of FHLBP advances	(240,678)	(46,167)
Funding of FHLBP advances	194,600	69,848
Net (decrease) increase in repurchase agreements	(12,023)	134
(Decrease) increase in other borrowings	(2,433)	2,320
Dividends paid	(1,204)	(1,194)
Payment of employee taxes on stock option exercise and share award vest	(365)	(635)
Net Cash Provided by Financing Activities	61,260	322
Net Change in Cash and Cash Equivalents	6,404	(11,186)
Cash and Cash Equivalents at Beginning of Period	10,917	22,103
Cash and Cash Equivalents at End of Period	\$ 17,321	\$ 10,917
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for:		
Interest	\$ 9,279	\$ 5,700
Income taxes	1,400	3,511

Supplemental Disclosure of  
Non-cash Flow Information:

Net decrease in goodwill	-	65
Transfers from loans to other real estate owned and other repossessed property	472	2,960
Purchased loans not yet funded	3,000	-

See accompanying notes to consolidated financial statements.

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## Notes to Consolidated Financial Statements

## (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DNB Financial Corporation (the “Corporation” or “DNB”) through its wholly owned subsidiary, DNB First, National Association (the “Bank”), formerly Downingtown National Bank, has been serving individuals and small to medium sized businesses of southeastern Pennsylvania since 1860. DNB Capital Trust I and II are special purpose Delaware business trusts, which are not consolidated as they are considered variable interest entities and the Corporation is not the primary beneficiary (see additional discussion in Junior Subordinated Debentures — Note 9). The Bank is a locally managed commercial bank providing personal and commercial loans and deposit products, in addition to investment and trust services from fifteen community offices. The Bank encounters vigorous competition for market share from commercial banks, thrift institutions, credit unions and other financial intermediaries.

The consolidated financial statements of DNB and its subsidiary, the Bank, which together are managed as a single operating segment (“Community Banking”), are prepared in accordance with U.S. generally accepted accounting principles applicable to the banking industry.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the Consolidated Statements of Financial Condition, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. Amounts subject to significant estimates are items such as the allowance for credit losses and lending related commitments, the fair value of repossessed assets, pension and post-retirement obligations, the fair value of financial instruments, other-than-temporary impairments of investment securities, the valuation of assets acquired and liabilities assumed in business combinations, and the valuations of goodwill for impairment. Among other effects, such changes could result in future impairments of investment securities, and establishment of allowances for credit losses and lending related commitments as well as increased benefit plans’ expenses.

**Reclassifications** Certain reclassifications have been made to prior years’ balances to conform to the classifications used in 2018. These reclassifications had no impact on DNB’s consolidated financial position, results of income or net change in cash and cash equivalents. The 2017 statement of cash flows includes the presentation of \$542,000 as non-cash funding of retirement plans, included in net cash provided by operating activities. This amount was previously reported as sale of treasury stock, included in net cash provided by financing activities, in the 2017 financial statements.

**Accounting Developments Affecting DNB** In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606).” The updated standard is a new comprehensive revenue recognition model that requires revenue to be recognized in a manner that depicts the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14 which deferred the effective date of ASU 2014-09 by one year. During 2016 and 2017, the FASB issued ASU Nos. 2016-10, 2016-12, 2016-20, and 2017-13 that provides additional guidance related to the identification of performance obligations within a contract, assessing collectability, contract costs, and other technical corrections and improvements.



DNB adopted the new standards effective January 1, 2018 using the modified retrospective approach. A significant majority of DNB's revenues are explicitly excluded from the scope of the new guidance including interest, dividend income, BOLI, gain/loss on sale of loans and investments on the Consolidated Statements of Income. The adoption of ASU 2014-09 did not require a cumulative adjustment to the opening balance of retained earnings as of January 1, 2018 and does not have a material impact on DNB's Consolidated Statements of Financial Condition, Comprehensive Income, Stockholders' Equity or Cash Flows for the year ended December 31, 2018. Non-interest income components in the scope of Topic 606 continue to be recognized when DNB's performance obligations are complete or at the time of sale after a customer's transaction posts in the account. Disclosures required for DNB's revenue streams in the scope of ASU 2014-09 are included in Non-Interest Income in the following table.

(Dollars in thousands)	Year Ended	
	December 31,	
	2018	2017
Non-interest Income:		
Service charges:		
Non-sufficient funds charges	\$ 605	\$ 696
Business analysis charges	180	175
Cycle charges	90	92
Lockbox fees	57	59
Stop payment fees	18	19
Wire transfer fees	89	87
Other service charges	80	95
Total service charges	1,119	1,223
Wealth management:		
DNB Investments & Insurance	545	506
DNB First Investment Management & Trust	1,410	1,207
Total wealth management	1,955	1,713
Other fee income:		
Cardholder interchange fees	1,047	989
Safe deposit box	97	99
Check printing	65	70
Merchant card processing	177	189
ATM surcharges for non-DNB customers	74	81
Other fee income	52	100
Total other fee income	1,512	1,528
Total revenue from contracts with customers	4,586	4,464
Total revenue not within the scope of ASC 606	659	954
Total non-interest income	\$ 5,245	\$ 5,418

Service charges on deposit accounts are recorded monthly when DNB's performance obligations are complete. Deposit balances are disclosed in the Consolidated Statement of Condition. For transaction-based service charges such as non-sufficient funds charges, wire transfer fees, stop payment fees, ATM fees, and other transaction-based fees, revenue is recognized at the time of sale after the transaction posts in the customer's account.

Wealth management revenue includes non-deposit products and services offered under the names "DNB Investment & Insurance" and "DNB First Investment Management & Trust".

Through a third-party marketing agreement with Cetera Investment Services, LLC ("Cetera"), DNB Investment & Insurance offers a complete line of investment and insurance products. DNB's performance obligation as an agent is to arrange for the sale of products by Cetera. Monthly, DNB recognizes commission fees in the amounts to which it is entitled in accordance with the terms of the marketing agreement for products sold. Shortly after a sale, the product provider remits the commission payment through Cetera to the Company, and the Company recognizes the revenue.

DNB First Investment Management & Trust offers a full line of investment and fiduciary services. DNB's performance obligation is to manage investments, estates and trusts. Investment management and trust income is primarily comprised of fees earned from the management and administration of trusts, estates and investment agency portfolios. The Company's performance obligation is generally satisfied over time and the resulting fees are recognized quarterly, based upon the quarter-end market value of the assets under management and the applicable fee rate. Payment is generally received a few days after quarter end through a direct charge to customers' accounts. While managing estates and trusts, DNB contracts with a third-party tax preparation service. For tax preparation services, DNB's obligation as an agent is to arrange for the performance of services by the third party. As tax services are rendered, DNB records revenue net of the cost of the services.

Cardholder interchange fees consist of revenue DNB is entitled per agreements with third party debit and credit card providers. DNB's performance obligation as an agent is to arrange for cardholder services with its customers in accordance with fees and terms offered by the third-party service providers. Based on cardholder transactions reported by third party service providers, DNB recognizes fees for the amount it is contractually entitled.

DNB also contracts with third party providers for check printing, merchant card services, and ATM services. DNB's performance obligation as an agent is to arrange for the services with its customers in accordance with fees and terms offered by the third-party service providers. Monthly, DNB recognizes fees for the amount it is contractually entitled.

DNB adopted ASU 2015-16, Business Combinations (Topic 805), in 2016: Simplifying the Accounting for Measurement Period Adjustments on a prospective basis. This amendment eliminates the requirement to account for adjustments to provisional amounts recognized in a business combination retrospectively. Instead, the acquirer will recognize the adjustments to provisional amounts during the period in which the adjustments are determined, including the effect on earnings of any amounts the acquirer would have recorded in previous periods if the accounting had been completed at the acquisition date. DNB evaluated the impact of this guidance and it does not have a material impact to the consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments – Overall (Subtopic 825-10) – Recognition and Measurement of Financial Assets and Financial Liabilities. The guidance addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. In particular, the guidance revises an entity's accounting related to (1) the classification and measurement of investments in equity securities and (2) the presentation of certain fair value changes for financial liabilities measured at fair value. The guidance also amends certain disclosure requirements associated with fair value of financial instruments. For public business entities, the guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Entities should apply the amendments by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. As of January 1, 2018, DNB did not hold any equity investments (excluding restricted investments in bank stocks). DNB does not expect to make significant purchases of equity investments; therefore, the adoption of this ASU is not material to DNB's consolidated financial statements. Adoption of the standard on January 1, 2018 also resulted in the use of an exit price rather than an entrance price to determine the fair value of loans not measured at fair value on a non-recurring basis in the consolidated balance sheets.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases. The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. DNB has determined that upon the adoption of ASU 2016-02 we will be required to recognize a right-of-use asset and a corresponding liability based on the then present value of such obligation. DNB expects that the adoption of ASU 2016-02 will result in the recognition of lease liabilities and right-of-use asset totaling approximately \$1.5 million. DNB does not expect that the adoption of the new standard will have a material impact on its Consolidated Statements of Income. Update 2018-11 - Leases (topic 842): Targeted Improvements provided an additional/optional transition method to adopt the new leases standard. Prior to this ASU issuance, a modified retrospective transition approach was required. The adoption of this ASU will not materially impact our Consolidated Statement of Financial Condition and Consolidated Statements of Changes in Stockholders' Equity. Update 2018-20 - Leases (topic 842): Narrow-Scope Improvements for Lessors was released to better clarify the treatment of sales taxes and other similar taxes related to Lessor and Lessees costs and payments. The amendments in this update permit lessors, as an accounting policy election, to not evaluate whether certain sales taxes and other similar taxes are lessor costs or lessee costs. Instead, those lessors will account for those costs as if they are lessee costs. Also, certain lessor costs require lessors to exclude from variable payments, and therefore revenue, lessor costs paid by lessees directly to third parties. DNB's lessor income is immaterial; as such, this ASU will not materially impact our Consolidated Statement of Financial Condition or Consolidated Statements of Comprehensive Income. DNB did not adopt the use-of-hindsight practical expedient.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," (ASU 2016-13), which addresses concerns regarding the perceived delay in recognition of credit losses under the existing incurred loss model. The amendment introduces a new, single model for recognizing credit losses on all financial instruments presented on cost basis. Under the new model, entities must estimate current expected credit losses by considering all available relevant information, including historical and current information, as well as reasonable and supportable forecasts of future events. The update also requires additional qualitative and quantitative information to allow users to better understand the credit risk within the portfolio and the methodologies for determining allowance. ASU 2016-13 is effective for DNB on January 1, 2020 and must be applied using the modified retrospective approach with limited exceptions. Early adoption is permitted. Although early adoption is permitted for fiscal years beginning after December 15, 2018, DNB does not plan to early adopt. DNB has established a CECL Implementation Team to assess the impact of this ASU on its consolidated financial position, results of operations, and cash flows. DNB has been preserving certain historical loan information from its core processing system in anticipation of adopting the standard and will be evaluating control and process framework, data, model, and resource requirements and areas where modifications will be required. DNB has selected a third party vendor to process and review various calculation methodologies and the approximate impact on DNB's financial position, results of operations and cash flows. The team continues to assess the impact of the standard; however, DNB expects adopting this ASU will result in an increase in its allowance for credit losses. The amount of the increase in the allowance for credit losses upon adoption will be dependent upon the characteristics of the portfolio at the adoption date, as well as macroeconomic conditions and forecasts at that date. A cumulative effect adjustment will be made to retained earnings for the impact of the standard at the beginning of the period the standard is adopted.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230). The amendments in this update provide guidance for eight specific cash flow classification issues for which current guidance is unclear or does not exist, thereby

reducing diversity in practice. For public companies, the update is effective for annual periods beginning after December 15, 2017. Accordingly, effective January 1, 2018, DNB adopted the pronouncement and it does not have a material impact to DNB's consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805), Clarifying the Definition of a Business. The new guidance narrows the existing definition of a business and provides a framework for evaluating whether a transaction should be accounted for as an acquisition (or disposal) of assets or a business. The guidance requires an entity to evaluate if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets; if so, the set of transferred assets and activities (collectively, the set) is not a business. To be considered a business, the set would need to include an input and a substantive process that together significantly contribute to the ability to create outputs, as defined by the ASU. The guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods within those annual reporting periods, and should be applied prospectively. Early adoption is permitted. DNB will apply this guidance to applicable transactions after the adoption date.

In January 2017, the Financial Accounting Standards Board ("FASB") issued ASU 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. The ASU simplifies the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. Instead, under the amendments, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value with its carrying amount. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount when measuring the goodwill impairment loss, if applicable. The update also eliminated the requirements for zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. The amendments are effective for public business entities for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. DNB will not early adopt this ASU for its annual goodwill impairment test, and has conducted a qualitative test (step zero) as of October 1, 2018 and determined that its Goodwill has not been impaired. The adoption of this ASU is not expected to have a material impact on DNB's consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." Under the new guidance, employers will present the service cost component of the net periodic benefit cost in the same income statement line item (e.g., Salaries and Benefits) as other employee compensation costs arising from services rendered during the period. In addition, only the service cost component will be eligible for capitalization in assets. Employers will present the other components separately (e.g., Other Noninterest Expense) from the line item that includes the service cost. ASU No. 2017-07 is effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption is permitted, however, DNB has decided not to early adopt. Employers will apply the guidance on the presentation of the components of net periodic benefit cost in the income statement retrospectively. ASU No. 2017-07 does not have a material impact on DNB Consolidated Financial Statements because the Pension plan has been frozen to new accruals since December 31, 2003, and thus, generated no service cost in any subsequent year.

In May 2017, the FASB issued ASU No. 2017-09, Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting; ("ASU 2017-09"). ASU 2017-09 provides clarity by offering guidance on the scope of

modification accounting for share-based payment awards and gives direction on which changes to the terms or conditions of these awards require an entity to apply modification accounting. Under the new guidance, modification accounting is required only if the fair value, the vesting conditions, or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions. The guidance is effective prospectively for all companies for annual periods beginning on or after December 15, 2017. Early adoption was permitted. DNB adopted the ASU on January 1, 2018 and the effects were immaterial.

In February 2018, the FASB issued ASU No. 2018-02, Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income; (“ASU 2018-02”). This ASU allows a reclassification from accumulated other comprehensive income (“AOCI”) to retained earnings for certain income tax effects stranded in AOCI as a result of the Tax Act. Consequently, the reclassification eliminates the stranded tax effects resulting from the Tax Act and is intended to improve the usefulness of information reported to financial statement users. However, because the ASU only relates to the reclassification of the income tax effects of the Tax Act, the underlying guidance that requires the effect of a change in tax laws or rates to be included in income from continuing operations is not affected. The amendments in this update are effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. DNB adopted this ASU on January 1, 2018. The amount of this reclassification is \$471,000.

**Principles of Consolidation** The accompanying consolidated financial statements include the accounts of DNB and its wholly owned subsidiary, the Bank. All significant inter company transactions have been eliminated.

**Cash and Due From Banks** For purposes of the consolidated statement of cash flows, cash and due from banks, and federal funds sold are considered to be cash equivalents. Generally, federal funds are sold for one-day periods.

Investment Securities Investment securities are classified at the time of purchase and accounted for as follows:

**Held-To-Maturity (“HTM”)** Includes debt securities that DNB has the positive intent and ability to hold to maturity. Debt securities are reported at cost, adjusted for amortization of premiums and accretion of discounts. DNB may sell HTM securities when DNB collects greater than 85% of the original recorded investment on the HTM securities prior to the sale.

**Available-For-Sale (“AFS”)** Includes debt and equity securities not classified as HTM securities. Securities classified as AFS are securities that DNB intends to hold for an indefinite period of time, but not necessarily to maturity. Such securities are reported at fair value, with unrealized holding gains and losses excluded from earnings and reported, net of tax (if applicable), as a separate component of stockholders’ equity. Realized gains and losses on the sale of AFS securities are computed on the basis of specific identification of the adjusted cost of each security. Amortization of premiums and accretion of discounts for all types of securities are computed using a level yield basis.

**Other Than Temporary Impairment (“OTTI”) Analysis** Securities are evaluated on a quarterly basis, and more frequently when market conditions warrant such an evaluation, to determine whether declines in their value are other-than-temporary. To determine whether a loss in value is other-than-temporary, management utilizes criteria such as the reasons underlying the decline, the magnitude and duration of the decline, and whether or not management intends to sell or expects that it is more likely than not that it will be required to sell the security prior to an anticipated recovery of the fair value. Once a decline in value for a debt security is determined to be other-than-temporary, the other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total impairment related to credit losses is included in earnings. The amount of the total impairment related to all other factors is included in other comprehensive income. DNB recorded no impairment charges in 2018 or 2017.

**Restricted Stock** Restricted investment in bank stocks consist of Philadelphia Federal Reserve Bank (“FRB”) stock, Pittsburgh Federal Home Loan Bank (“FHLBP”) stock, and Atlantic Community Bankers Bank (“ACBB”) stock. Federal law requires a member institution of the district FRB and FHLB to hold stock according to predetermined formulas. ACBB requires its correspondent banking institutions to hold stock as a condition of membership. The restricted investment in bank stock is carried at cost. Quarterly, the Corporation evaluates the bank stocks for impairment. DNB evaluates recent and long-term operating performance, liquidity, funding and capital positions, stock repurchase history, dividend history, and impact of legislative and regulatory changes. At December 31, 2018, DNB owned \$3.1 million of stock of the FHLBP, \$2.3 million of stock of the FRB and \$156,000 of stock of ACBB. At December 31, 2017, DNB owned \$5.2 million of stock of the FHLBP, \$2.3 million of stock of the FRB and \$156,000 of stock of ACBB.

**Loans** Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for credit losses and any deferred fees or costs. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield (interest income) of the related loans. DNB is generally amortizing these amounts over the contractual life of the loan. Premiums and discounts on purchased loans are amortized as adjustments to interest income using the effective yield method.



The loans receivable portfolio is segmented into residential mortgage loans, commercial mortgage loans, commercial loans (which consist of commercial term loans and commercial construction loans), leases, and consumer loans (which consist of home equity loans and other consumer loans.)

For all classes of loans receivable, the accrual of interest is generally discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan or lease is placed on non-accrual, interest accruals cease and uncollected accrued interest is reversed and charged against current income. Interest received on nonaccrual loans, including impaired loans, generally is either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments.

**Loans acquired in business combinations** Loans that DNB acquires in connection with business combinations are recorded at fair value with no carryover of the existing related allowance for credit losses. Fair value of the loans involves estimating the amount and timing of principal and interest cash flows expected to be collected on the loans and discounting those cash flows at a market rate of interest.

For loans acquired with credit deterioration, the excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable discount and is recognized into interest income over the remaining life of the loan. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the

nonaccretable discount. These loans are accounted for under the Accounting Standard Codification (“ASC”) 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality. The nonaccretable discount includes estimated future credit losses expected to be incurred over the life of the loan. Subsequent decreases to the expected cash flows will require DNB to evaluate the need for an additional allowance for credit losses. Subsequent improvement in expected cash flows will result in the reversal of a corresponding amount of the nonaccretable discount which DNB will then reclassify as accretable discount that will be recognized into interest income over the remaining life of the loan.

Loans acquired through business combinations that do meet the specific criteria of ASC 310-30 are individually evaluated each period to analyze expected cash flows. To the extent that the expected cash flows of a loan have decreased due to credit deterioration, DNB establishes an allowance.

Loans acquired through business combinations that do not meet the specific criteria of ASC 310-30 are accounted for under ASC 310-20. These loans are initially recorded at fair value, and include credit and interest rate marks associated with acquisition accounting adjustments. Purchase premiums or discounts are subsequently amortized as an adjustment to yield over the estimated contractual lives of the loans. There is no allowance for credit losses established at the acquisition date for acquired performing loans. An allowance for credit losses is recorded for any credit deterioration in these loans subsequent to acquisition.

Acquired loans that met the criteria for impaired or nonaccrual of interest prior to the acquisition may be considered performing upon acquisition, regardless of whether the customer is contractually delinquent if DNB expects to fully collect the new carrying value (i.e. fair value) of the loans. As such, DNB may no longer consider the loan to be nonaccrual or nonperforming and may accrue interest on these loans, including the impact of any accretable discount. In addition, charge-offs on such loans would be first applied to the nonaccretable difference portion of the fair value adjustment.

**Deferred Loan Fees and Costs** Loan origination and commitment fees and related direct-loan origination costs of completed loans are deferred and accreted to income as a yield adjustment over the life of the loan using the level yield method. The accretion to income is discontinued when a loan is placed on non-accrual status. When a loan is paid off, any unamortized net deferred fee balance is credited to income. When a loan is sold, any unamortized net deferred fee balance is considered in the calculation of gain or loss.

**Allowance for Credit Losses** The allowance for credit losses represents management’s estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The allowance for credit losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for credit losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Non-residential consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of Bankruptcy, or if there is an amount deemed uncollectible. No portion of the allowance for credit losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

The allowance for credit losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on DNB’s past loan loss experience, known and inherent risks in the portfolio, adverse situations that may

affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate, home equity and other consumer loans. These pools of loans are evaluated for loss exposure, based upon historical loss rates for each of these categories of loans, adjusted for qualitative factors. These qualitative risk factors include:

- 1.Lending policies and procedures, including underwriting standards and collection, charge-off and recovery practices
- 2.National, regional, and local economic and business conditions as well as the condition of various market segments, including the value of underlying collateral for collateral dependent loans
- 3.Nature and volume of the portfolio and terms of loans
- 4.Experience, ability, and depth of lending management and staff
- 5.Volume and severity of past due, classified and nonaccrual loans as well as other loan modifications

6. Quality of DNB's loan review system, and the degree of oversight by DNB's Board of Directors
7. Existence and effect of any concentrations of credit and changes in the level of such concentrations
8. Effect of external factors, such as competition and legal and regulatory requirements
9. Changes in the value of underlying collateral for collateral dependent loans

Each factor is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for credit loss calculation.

Residential mortgage loans involve certain risks such as interest rate risk and risk of non-repayment. Adjustable-rate single family real estate loans decreases the interest rate risk to the Company that is associated with changes in interest rates but involve other risks, primarily because as interest rates rise, the payment by the borrower rises to the extent permitted by the terms of the loan, thereby increasing the potential for default. At the same time, the marketability of the underlying property may be adversely affected by higher interest rates. Repayment risk can be affected by job loss, divorce, illness and personal bankruptcy or the borrower.

Commercial real estate lending entails significant additional risks as compared with single family residential property lending. Such loans typically involve large loan balances to single borrowers or groups of related borrowers. The payment experience on such loans is typically dependent on the successful operation of the real estate project. The success of such projects is sensitive to changes in supply and demand conditions in the market for commercial real estate as well as economic conditions generally.

Commercial loans, which are also referred to as commercial and industrial loans ("C & I loans"), include advances to businesses for general commercial purposes and include permanent and short-term working capital, machinery and equipment financing, and may be either in the form of lines of credit or term loans. Although C & I loans may be unsecured to our highest rated borrowers, the majority of these loans are secured by the borrower's accounts receivable, inventory and machinery and equipment. In a significant number of these loans, the collateral also includes the business real estate or the business owner's personal real estate or assets. C & I loans present credit exposure to DNB, as they are more susceptible to risk of loss during a downturn in the economy, as borrowers may have greater difficulty in meeting their debt service requirements and the value of the collateral may decline. DNB attempts to mitigate this risk through its underwriting standards, including evaluating the credit worthiness of the borrower and to the extent available, credit ratings on the business. Additionally, monitoring of the loans through annual renewals and meetings with the borrowers are typical. However, these procedures cannot eliminate the risk of loss associated with this type of lending.

Construction lending is generally considered to involve a higher level of risk as compared to single family residential lending, due to the concentration of principal in a limited number of loans and borrowers and the effects of general economic conditions on developers and builders. Moreover, a construction loan can involve additional risks because of the inherent difficulty in estimating both a property's value at completion of the project and the estimated cost (including interest) of the project. The nature of these loans is such that they are generally more difficult to evaluate and monitor. DNB has attempted to minimize the foregoing risks by, among other things, limiting the extent of its construction lending and has adopted underwriting guidelines which impose stringent loan-to-value, debt service and other requirements for loans which are believed to involve higher elements of credit risk, by limiting the geographic area in which DNB will do business and by working with builders with whom it has established relationships.

Consumer loans generally have shorter terms and higher interest rates than mortgage loans but generally involve more credit risk than mortgage loans because of the type and nature of the collateral and, in certain cases, the absence of collateral. In addition, consumer lending collections are dependent on the borrower's continuing financial stability, and

thus are more likely to be adversely effected by job loss, divorce, illness and personal bankruptcy. In most cases, any repossessed collateral for a defaulted consumer loan will not provide an adequate source of repayment of the outstanding loan balance because of improper repair and maintenance of the underlying security. The remaining deficiency often does not warrant further substantial collection efforts against the borrower. DNB believes that the generally higher yields earned on consumer loans compensate for the increased credit risk associated with such loans and that consumer loans are important to its efforts to provide a full range of services to its customers.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that DNB will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay,

the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and industrial loans, commercial real estate loans and commercial construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance for credit losses is established for an impaired loan if its carrying value exceeds its estimated fair value. The estimated fair values of substantially all of DNB's impaired loans are measured based on the estimated fair value of the loan's collateral.

For commercial loans secured by real estate, estimated fair values are determined primarily through third party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For commercial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable agings or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

We perform separate impairment analyses once residential or consumer loans become significantly delinquent. This is essentially the same process for all loan types. Once on non-accrual or at 90 days delinquent (if not before), we generally get updated valuations (appraisals, etc.) and then perform the impairment analysis. So, the general reserve is used to cover the performing loans until we pull out the problem accounts.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments, for commercial and consumer loans. Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful and loss. Loans criticized special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses. Loans not classified are rated pass.

In addition, Federal regulatory agencies, as an integral part of their examination process, periodically review DNB's allowance for credit losses and may require DNB to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for credit losses is appropriate.

**Troubled Debt Restructurings** Loans whose terms are modified are classified as troubled debt restructurings ("TDR") if DNB grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate or an extension of a loan's stated maturity date. Non-accrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after modification. Loans classified as troubled debt restructurings are designated as impaired. The recorded investments in troubled debt restructured loans at December 31, 2018 and 2017 are as follows:



(Dollars in thousands)	December 31, 2018		
	Pre-Modification		Post-Modification
	Outstanding	Outstanding	Recorded
	Recorded Investment	Recorded Investment	Investment
Residential mortgage	\$ 676	\$ 805	\$ 630
Commercial mortgage	992	992	962
Consumer:			
Home equity	148	148	140
Other	40	42	30
Total	\$ 1,856	\$ 1,987	\$ 1,762

(Dollars in thousands)	December 31, 2017		
	Pre-Modification		Post-Modification
	Outstanding	Outstanding	Recorded
	Recorded Investment	Recorded Investment	Investment
Residential mortgage	\$ 754	\$ 883	\$ 690
Commercial mortgage	992	992	982
Consumer:			
Home equity	148	148	146
Other	40	42	39
Total	\$ 1,934	\$ 2,065	\$ 1,857

At December 31, 2018, DNB had nine TDRs with recorded investment totaling \$1,762,000, all of which were accruing loans in compliance with the terms of the modifications. As a result of collateral evaluations, specific reserves and charge-offs have been taken where appropriate. As of December 31, 2018, DNB recognized partial charge-offs totaling \$151,000 on two residential loans prior to their restructuring and \$2,000 on one consumer installment loan after its restructuring. As of December 31, 2018, there were no defaulted TDRs as all TDRs were current with respect to their associated forbearance agreements. There were no defaults on TDRs within twelve months of restructure during 2018. DNB classified one residential mortgage loan totaling \$73,000 as TDRs during the year ended December 31, 2018.

At December 31, 2017, DNB had eight TDRs with recorded investment totaling \$1,857,000, five of which, totaling \$1,128,000, were accruing loans in compliance with the terms of the modifications. The remaining \$729,000 represents three loans that were nonaccrual impaired loans and resulted in collateral evaluations. As a result of the evaluations, specific reserves and charge-offs have been taken where appropriate. As of December 31, 2017, DNB recognized partial charge-offs totaling \$151,000 on two residential loans prior to their restructuring and \$2,000 on one consumer installment loan after its restructuring. As of December 31, 2017, there were no defaulted TDRs as all TDRs were current with respect to their associated forbearance agreements. There were no defaults on TDRs within twelve months of restructure during 2017. DNB classified three commercial mortgage loans totaling \$992,000 as TDRs during the year ended December 31, 2017.



**Reserve for unfunded loan commitments** The reserve for unfunded loan commitments represents management's estimate of losses inherent in off-balance sheet items related to the loan portfolio which consist of commitments to extend credit and letters of credit. The same risk and loss factors are applied to both funded and unfunded commitments. However, the bank calculates reserves required to support unfunded commitments in each loan category based only on the estimated likelihood (the probability) that DNB would advance funds into a known troubled situation, and then sustain a loss on the newly advanced funds. The amount of reserve for unfunded loan commitments, which is included in "Other liabilities" on the statement of financial condition, was \$395,000 and \$348,000 at December 31, 2018 and December 31, 2017, respectively.

**Other Real Estate Owned & Other Repossessed Property** Other real estate owned ("OREO") and other repossessed property consists of properties acquired as a result of, or in-lieu-of, foreclosure as well as other repossessed property. Properties classified as OREO are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying value or fair value, less estimated costs to sell. Costs relating to the development or improvement of the properties are capitalized and costs relating to holding the properties are charged to expense. DNB had \$58,000 and \$416,000 of commercial mortgage loans in the process of foreclosure at December 31, 2018 and December 31, 2017, respectively.

**Office Properties and Equipment** Office properties and equipment are recorded at cost. Depreciation is computed using the straight-line method over the expected useful lives of the assets. The costs of maintenance and repairs are expensed as they are incurred; renewals and betterments are capitalized. All long-lived assets are reviewed for impairment when conditions indicate that impairment may have occurred, based on the fair value of the asset. In addition, long-lived assets to be disposed of are generally reported at the lower of carrying amount or fair value, less cost to sell. Gains or losses on disposition of properties and equipment are reflected in operations.

**Goodwill and Intangible Assets** DNB accounts for goodwill and intangible assets in accordance with ASC 350, “Intangibles – Goodwill and Other.” Goodwill is the excess of the purchase price over the fair value of the net assets acquired in connection with the 2016 acquisition of East River Bank. If certain events occur, which indicate goodwill might be impaired between annual tests, goodwill must be tested when such events occur. In making this assessment, DNB considers a number of factors including operating results, business plans, economic projections, anticipated future cash flows, current market data, stock price, etc. There are inherent uncertainties related to these factors and management’s judgment in applying them to the analysis of goodwill impairment. Changes in economic and operating conditions could result in goodwill impairment in future periods. DNB did not identify any impairment during 2018. The annual test date is October 1st. DNB has conducted a qualitative test (step zero) as of October 1, 2018 and determined that its Goodwill has not been impaired.

**Income Taxes** DNB accounts for income taxes in accordance with the income tax accounting guidance set forth in FASB ASC Topic 740, Income Taxes.

The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. DNB determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

DNB recognizes interest and penalties on income taxes as a component of income tax expense. DNB is no longer subject to examinations by taxing authorities for the years before January 1, 2015. DNB had no unrecognized tax positions as of December 31, 2018.

**Pension Plan** The Bank maintains a noncontributory defined benefit pension plan covering substantially all employees over the age of 21 with one year of service. Plan benefits are based on years of service and the employee’s monthly average compensation for the highest five consecutive years of their last ten years of service (see Note 13 — Benefit Plans). The Bank recognizes the overfunded or underfunded status of pension and other post retirement benefit plans on the balance sheet. Gains and losses, prior service costs and credits, and any remaining transition amounts that have not yet been recognized through net periodic benefit cost will be recognized in accumulated other comprehensive income, net of tax effects, until they are amortized as a component of net periodic cost.

**Stock Based Compensation** Stock compensation accounting guidance (FASB ASC Topic 718, Compensation — Stock Compensation) requires that the compensation cost relating to share based payment transactions be recognized in financial statements. That cost will be measured based on the grant date fair value of the equity or liability instruments issued. The stock compensation accounting guidance covers a wide range of share based compensation arrangements including stock options, restricted share plans, performance based awards, share appreciation rights, and employee share purchase plans.

The stock compensation accounting guidance requires that compensation cost for all stock awards be calculated and recognized over the employees’ service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. A Black Sholes model is used to estimate the fair value of stock options. The market price of DNB’s common stock at the date of grant is used for restricted stock awards.

**Earnings Per Common Share (EPS)** Basic EPS is computed based on the weighted average number of common shares outstanding during the year. Diluted EPS reflects the potential dilution that could occur from unvested stock awards and the exercise of stock options and award vests computed using the treasury stock method. Stock options and awards for which the exercise price exceeds the average market price over the period have an anti-dilutive effect on EPS and, accordingly, are excluded from the EPS calculation. Treasury shares are not deemed outstanding for

earnings per share calculations.

Comprehensive Income Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale, accretion of discount on securities transferred from available-for-sale to held-to-maturity, and changes in the funded status of the pension plan of which the accumulated amounts are also recognized as separate components of stockholders' equity.

Accumulated Other Comprehensive Loss (Dollars in thousands)	Before-Tax Amount	Tax Effect	Net-of-Tax Amount
December 31, 2018			
Net unrealized loss on AFS securities	\$ (2,122)	\$ 445	\$ (1,677)
Unrealized actuarial losses-pension	(1,637)	343	(1,294)
	\$ (3,759)	\$ 788	\$ (2,971)
December 31, 2017			
Net unrealized loss on AFS securities	\$ (1,772)	\$ 603	\$ (1,169)
Unrealized actuarial losses-pension	(1,849)	628	(1,221)
	\$ (3,621)	\$ 1,231	\$ (2,390)

Treasury Stock Shares of the Company's common stock which are repurchased on the open market are classified as treasury stock on the consolidated balance sheet. Treasury stock is recorded at the cost at which it was obtained in the open market, and at the date of reissuance, treasury stock on the consolidated balance sheet is reduced by the cost for which it was purchased, using a weighted average price of the remaining treasury stock.

**Bank-Owned Life Insurance** The Bank is the beneficiary of insurance policies on the lives of certain officers of the Bank. The Bank has recognized the amount that could be realized under the insurance policies as an asset in the consolidated statements of financial condition.

**Trust Assets** Assets held by DNB First Wealth Management, a wholly owned subsidiary of the Bank, in fiduciary or agency capacities are not included in the consolidated financial statements since such items are not assets of DNB. Operating income and expenses of DNB First Wealth Management are included in the consolidated statements of income and are recorded on an accrual basis.

**Advertising and Marketing Costs** DNB follows the policy of charging the costs of advertising and marketing to expense as incurred. Advertising and marketing costs were approximately \$711,000 and \$755,000 for the years ended December 31, 2018 and December 31, 2017, respectively.

**Significant Concentrations of Credit Risk** Most of DNB's activities are with customers located throughout southeastern Pennsylvania. DNB's commercial portfolio has a concentration in loans to commercial real estate investors and developers as defined by regulation. There are numerous risks associated with commercial loans that could impact the borrower's ability to repay on a timely basis. They include, but are not limited to: the owner's business expertise; changes in local, national, and in some cases international economies; competition; governmental regulation; and the general financial stability of the borrowing entity.

DNB attempts to mitigate these risks by completing an analysis of the borrower's business and industry history, the borrower's financial position, as well as that of the business owner. DNB will also require the borrower to periodically provide financial information on the operation of the business over the life of the loan. In addition, most commercial loans are secured by assets of the business or those of the business owner, which can be liquidated if the borrower defaults, along with the personal surety of the business owner.

**Subsequent Events** Management has evaluated events and transactions occurring subsequent to December 31, 2018 for items that should potentially be recognized or disclosed in these Consolidated Financial Statements. The evaluation was conducted through the date these financial statements were issued.

## (2) INVESTMENT SECURITIES

The amortized cost and estimated fair values of investment securities, as of the dates indicated, are summarized as follows:

(Dollars in thousands)	December 31, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Held To Maturity				
US Government agency obligations	\$ 8,749	\$ 41	\$ -	\$ 8,790
Government Sponsored Entities (GSE) mortgage-backed securities	389	-	-	389
Corporate bonds	13,851	124	(47)	13,928
Collateralized mortgage obligations GSE	1,159	-	(27)	1,132
State and municipal taxable	362	-	(3)	359
State and municipal tax-exempt	37,516	19	(998)	36,537
Total	\$ 62,026	\$ 184	\$ (1,075)	\$ 61,135
Available For Sale				
US Government agency obligations	\$ 48,082	\$ -	\$ (359)	\$ 47,723
GSE mortgage-backed securities	27,563	-	(1,005)	26,558
Collateralized mortgage obligations GSE	10,249	-	(441)	9,808
Corporate bonds	10,890	-	(186)	10,704
State and municipal tax-exempt	1,981	-	(131)	1,850
Total	\$ 98,765	\$ -	\$ (2,122)	\$ 96,643

(Dollars in thousands)	December 31, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Held To Maturity				
US Government agency obligations	\$ 8,483	\$ 163	\$ -	\$ 8,646
Government Sponsored Entities (GSE) mortgage-backed securities	496	9	-	505
Corporate bonds	14,047	243	(2)	14,288
Collateralized mortgage obligations GSE	1,471	-	(29)	1,442
State and municipal taxable	363	-	(8)	355
State and municipal tax-exempt	37,530	59	(405)	37,184
Total	\$ 62,390	\$ 474	\$ (444)	\$ 62,420
Available For Sale				
US Government agency obligations	\$ 53,279	\$ -	\$ (386)	\$ 52,893
GSE mortgage-backed securities	33,203	-	(715)	32,488

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Collateralized mortgage obligations GSE	12,101	-	(447)	11,654
Corporate bonds	12,981	12	(173)	12,820
State and municipal tax-exempt	1,991	-	(63)	1,928
Total	\$ 113,555	\$ 12	\$ (1,784)	\$ 111,783

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Included in unrealized losses are market losses on securities that have been in a continuous unrealized loss position for twelve months or more and those securities that have been in a continuous unrealized loss position for less than twelve months. The table below details the aggregate unrealized losses and aggregate fair value of the underlying securities whose fair values are below their amortized cost at December 31, 2018 and 2017.

	December 31, 2018		Fair value Impaired Less Than 12 Months	Unrealized Loss Less Than 12 Months	Fair value Impaired More Than 12 Months	Unrealized Loss More Than 12 Months
	Total	Unrealized				
	Total	Unrealized				
	Fair Value	Loss				
(Dollars in thousands)						
Held To Maturity						
Corporate bonds	\$ 4,157	\$ (47)	\$ 1,887	\$ (15)	\$ 2,270	\$ (32)
Collateralized mortgage obligations GSE	1,132	(27)	-	-	1,132	(27)
State and municipal taxable	359	(3)	-	-	359	(3)
State and municipal tax-exempt	26,466	(998)	2,045	(31)	24,421	(967)
Total	\$ 32,114	\$ (1,075)	\$ 3,932	\$ (46)	\$ 28,182	\$ (1,029)
Available For Sale						
US Government agency obligations	\$ 37,723	\$ (359)	\$ -	\$ -	\$ 37,723	\$ (359)
GSE mortgage-backed securities	26,558	(1,005)	-	-	26,558	(1,005)
Collateralized mortgage obligations GSE	9,808	(441)	-	-	9,808	(441)
Corporate bonds	10,704	(186)	2,035	(7)	8,669	(179)
State and municipal tax-exempt	1,850	(131)	-	-	1,850	(131)
Total	\$ 86,643	\$ (2,122)	\$ 2,035	\$ (7)	\$ 84,608	\$ (2,115)

	December 31, 2017		Fair value Impaired Less Than 12 Months	Unrealized Loss Less Than 12 Months	Fair value Impaired More Than 12 Months	Unrealized Loss More Than 12 Months
	Total	Unrealized				
	Total	Unrealized				
	Fair Value	Loss				
(Dollars in thousands)						
Held To Maturity						
Corporate bonds	\$ 498	\$ (2)	\$ 498	\$ (2)	\$ -	\$ -
Collateralized mortgage obligations GSE	1,442	(29)	620	(5)	822	(24)
State and municipal taxable	355	(8)	355	(8)	-	-
State and municipal tax-exempt	20,240	(405)	6,775	(67)	13,465	(338)
Total	\$ 22,535	\$ (444)	\$ 8,248	\$ (82)	\$ 14,287	\$ (362)
Available For Sale						
US Government agency obligations	\$ 52,893	\$ (386)	\$ 30,894	\$ (185)	\$ 21,999	\$ (201)
GSE mortgage-backed securities	32,488	(715)	9,055	(133)	23,433	(582)
	11,654	(447)	2,132	(56)	9,522	(391)

## Collateralized mortgage obligations

## GSE

Corporate bonds	10,759	(173)	4,572	(43)	6,187	(130)
State and municipal tax-exempt	1,928	(63)	288	(2)	1,640	(61)
Total	\$ 109,722	\$ (1,784)	\$ 46,941	\$ (419)	\$ 62,781	\$ (1,365)

As of December 31, 2018, there were nineteen GSE mortgage-backed securities, forty-three tax-exempt municipalities, one taxable municipality, eleven corporate bonds, seven agency notes, and nineteen collateralized mortgage obligations which were in an unrealized loss position. DNB does not intend to sell these securities and management does not expect to be required to sell any of these securities prior to a recovery of their cost basis. Management has reviewed all of these securities and believes that DNB will collect all principal and interest that is due on debt securities on a timely basis. Management does not believe any individual unrealized loss as of December 31, 2018 represents an other-than-temporary impairment. DNB reviews its investment portfolio on a quarterly basis judging each investment for OTTI. The OTTI analysis focuses on the duration and the amount a particular security is below book value.

Factors affecting the market price include credit risk, market risk, interest rates, economic cycles, and liquidity risk. The magnitude of any unrealized loss may be affected by the relative concentration of DNB's investment in any one issuer or industry. DNB has established policies to reduce exposure through diversification of concentration of the investment portfolio including limits on concentrations to any one issuer and as such, management believes the investment portfolio is prudently diversified.

The declines in value are related to a change in interest rates and/or subsequent change in credit spreads required for these issues affecting market price. All issues are performing and are expected to continue to perform in accordance with their respective contractual terms and conditions. Short to intermediate average durations and in certain cases monthly principal payments should reduce further market value exposure to increases in rates.



**Collateralized mortgage obligations GSE** There are nineteen impaired securities classified as collateralized mortgage obligations, all of which were impaired for more than 12 months. The largest unrealized loss of a security in this group is 7.13% of its carrying value. All of these securities were issued and insured by FNMA, FHLMC or GNMA. DNB receives monthly principal and interest payments on all of these securities on a timely basis and none of these agencies has ever defaulted on mortgage-backed principal or interest. DNB anticipates a recovery in the market value as the securities approach their maturity dates or if interest rates decline from December 31, 2018 levels. Management concluded that these securities were not other-than-temporarily impaired at December 31, 2018.

**State and municipal tax-exempt** There are forty-three impaired securities in this category, which are comprised of intermediate to long-term municipal bonds, forty of which were impaired for more than 12 months. The largest unrealized loss of a security in this group is 10.18% of its carrying value. All of the issues carry a “BBB-” or better underlying credit support and were evaluated on the basis on their underlying fundamentals; included but not limited to annual financial reports, geographic location, population, and debt ratios. In certain cases, options for calls reduce the effective duration and in turn the future market value fluctuations. All issues are performing and are expected to continue to perform in accordance with their respective contractual terms and conditions. There have not been disruptions of any payments, associated with any of these municipal securities. These bonds are conservative in nature and the value decline is related to the changes in interest rates that occurred since the time of purchase and subsequent changes in spreads affecting the market prices. Twenty-eight of the impaired municipals are school districts that have state school district credit enhancement programs and twenty of those also have additional insurance. The remaining fifteen are two insured school districts, two uninsured school districts, four insured townships and seven uninsured townships, all of which have strong underlying ratings. Management concluded that these securities were not other-than-temporarily impaired at December 31, 2018.

**State and municipal taxable** There is one impaired security in this category, which has been impaired for more than 12 months. The unrealized loss of this security is 0.97% of its carrying value. This security is an insured township and carries a “BBB+” underlying credit. It is performing and is expected to continue to perform in accordance with its contractual terms and conditions. There have not been disruptions of any payments associated with this municipal security. Management concluded that this security was not other-than-temporarily impaired at December 31, 2018.

**US Government agency obligations** There are seven impaired securities classified as agencies, all of which were impaired for more than 12 months. The largest unrealized loss of a security in this group is 4.18% of its carrying value. All of these securities were issued and insured by FHLB, FNMA, or FHLMC. DNB has received timely interest payments on all of these securities and none of these agencies has ever defaulted on their bonds. DNB anticipates a recovery in the market value as the securities approach their maturity dates. Management concluded that these securities were not other-than-temporarily impaired at December 31, 2018.

**GSE mortgage-backed securities** There are nineteen impaired bonds classified as GSE mortgage-backed securities, all of which were impaired for more than 12 months. The largest unrealized loss of a security in this group is 4.86% of its carrying value. All of these securities were issued and insured by FNMA, FHLMC or GNMA. DNB receives monthly principal and interest payments on all of these securities on a timely basis and none of these agencies has ever defaulted on mortgage-backed principal or interest. DNB anticipates a recovery in the market value as the securities approach their maturity dates or if interest rates decline from December 31, 2018 levels. Management concluded that these securities were not other-than-temporarily impaired at December 31, 2018.

**Corporate bonds** There were eleven impaired bonds classified as corporate bonds, seven of which were impaired for more than 12 months. The largest unrealized loss of a security in this group is 4.15% of its carrying value. The bonds are investment grade and the value decline is related to the changes in interest rates that occurred since the time of purchase and subsequent changes in spreads affecting the market prices. All of the issues carry a “BBB+” or better underlying credit rating and were evaluated on the basis of their underlying fundamentals; included but not limited to annual financial reports, rating agency reports, capital strength and debt ratios. DNB anticipates a recovery in the market value as the securities approach their maturity dates or if interest rates decline from December 31, 2018 levels.

Management concluded that these securities were not other-than-temporarily impaired at December 31, 2018.

In determining that the securities giving rise to the previously mentioned unrealized losses were not other than temporary, DNB evaluated the factors cited above, which DNB considers when assessing whether a security is other-than-temporarily impaired. In making these evaluations DNB must exercise considerable judgment.

Accordingly, there can be no assurance that the actual results will not differ from DNB's judgments and that such differences may not require the future recognition of other-than-temporary impairment charges that could have a material effect on DNB's financial position and results of operations. In addition, the value of, and the realization of any loss on, an investment security is subject to numerous risks as cited above.

The amortized cost and estimated fair value of investment securities as of December 31, 2018, by final contractual maturity, are shown below. Actual maturities may differ from contractual maturities because certain securities may be called or prepaid without penalties.

(Dollars in thousands)	Held to Maturity		Available for Sale	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 11,599	\$ 11,640	\$ 22,755	\$ 22,674
Due after one year through five years	11,715	11,714	33,134	32,791
Due after five years through ten years	29,359	28,992	18,990	18,380
Due after ten years	9,353	8,789	23,886	22,798
Total investment securities	\$ 62,026	\$ 61,135	\$ 98,765	\$ 96,643

The principal values of investment securities sold as of the dates indicated are shown below. The HTM securities sold during 2017 were sold in accordance with GAAP, as DNB collected greater than 85% of the original recorded investment on the HTM securities prior to the sale. As a result, it is appropriate to continue to carry the remaining HTM portfolio as currently classified.

(Dollars in thousands)	Year Ended December 31	
	2018	2017
Available for sale securities sold	\$ -	\$ 3,030
Held to maturity securities sold	-	737
Total sold securities	\$ -	\$ 3,767

Gains and losses resulting from investment sales, redemptions or calls were as follows:

(Dollars in thousands)	Year Ended December 31	
	2018	2017
Gross realized gains-AFS	\$ -	\$ 10
Gross realized gains-HTM	-	41
Gross realized losses-AFS	-	(1)
Net realized gain	\$ -	\$ 50

At December 31, 2018 and 2017, investment securities with a carrying value of approximately \$95.8 million and \$105.9 million, respectively, were pledged to secure public funds, repurchase agreements, FHLBP advances, and for other purposes as required by law. See Note 7 regarding the use of certain securities as collateral.

## (3) LOANS

The major classifications of loans outstanding, net of fair value marks and deferred loan origination fees and costs are summarized as follows.

	December 31	
(Dollars in thousands)	2018	2017
Residential mortgage	\$ 99,932	\$ 93,959
Commercial mortgage	535,735	484,868
Commercial:		
Commercial term	166,335	129,535
Commercial construction	76,302	75,014
Consumer:		
Home equity	51,536	56,844
Other	5,131	5,677
Total loans	\$ 934,971	\$ 845,897
Less allowance for credit losses	(6,675)	(5,843)
Net loans	\$ 928,296	\$ 840,054

Some of DNB's directors and executive officers, and their related interests had transactions with the Bank in the ordinary course of business. It is anticipated that similar transactions will occur in the future.

(Dollars in thousands)	2018	2017
Related party loans at beginning of period	\$ 393	\$ 508
Advances	845	296
Repayments	(318)	(411)
Related party loans at end of period	\$ 920	\$ 393

## (4) ALLOWANCE FOR CREDIT LOSSES

The performance and credit quality of the loan portfolio is monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the past due status as of December 31, 2018 and December 31, 2017:

## Age Analysis of Past Due Loans Receivables

December 31, 2018							
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loans Receivables	Loans Receivable > 90 Days and Accruing
(Dollars in thousands)							
Residential mortgage	\$ 666	\$ 1,742	\$ 845	\$ 3,253	\$ 96,679	\$ 99,932	\$ 130
Commercial mortgage (less acquired with credit deterioration)	-	-	840	840	534,739	535,579	103
Acquired commercial mortgage with credit deterioration	-	-	-	-	156	156	-
Commercial:							
Commercial term	20	37	957	1,014	165,321	166,335	-
Commercial construction	-	-	-	-	76,302	76,302	-
Consumer:							
Home equity	398	144	247	789	50,747	51,536	-
Other	26	-	108	134	4,997	5,131	-
Total	\$ 1,110	\$ 1,923	\$ 2,997	\$ 6,030	\$ 928,941	\$ 934,971	\$ 233

December 31, 2017							
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loans Receivables	Loans Receivable > 90 Days and Accruing
(Dollars in thousands)							
Residential mortgage (less acquired with credit deterioration)	\$ 887	\$ 349	\$ 1,148	\$ 2,384	\$ 91,568	\$ 93,952	\$ -
Acquired residential mortgage with credit deterioration	-	-	7	7	-	7	-
	221	-	1,126	1,347	483,105	484,452	-

Commercial mortgage (less acquired with credit deterioration)

Acquired commercial mortgage with credit deterioration	-	-	416	416	-	416	-
Commercial:							
Commercial term	381	13	1,654	2,048	127,487	129,535	-
Commercial construction	514	-	-	514	74,500	75,014	-
Consumer:							
Home equity	15	-	386	401	56,443	56,844	-
Other	13	139	156	308	5,369	5,677	54
Total	\$ 2,031	\$ 501	\$ 4,893	\$ 7,425	\$ 838,472	\$ 845,897	\$ 54

DNB had no residential mortgage loans in the process of foreclosure and \$97,000 in residential real estate in other real estate owned as of December 31, 2018. DNB had \$638,000 residential mortgage loans in the process of foreclosure and \$149,000 in residential real estate in other real estate owned as of December 31, 2017.

The following table sets forth those assets that are: (i) placed on non-accrual status, (ii) contractually delinquent by 90 days or more and still accruing, and (iii) OREO as a result of foreclosure or voluntary transfer to DNB as well as other repossessed assets. Interest that would have been recognized on nonaccrual loans had they been current in accordance with their original terms was \$402,000 and \$589,000 for the years ended December 31, 2018 and December 31, 2017, respectively.

## Non-Performing Assets

(Dollars in thousands)	December 31	
	2018	2017
Non-accrual loans:		
Residential mortgage	\$ 905	\$ 1,915
Commercial mortgage	1,307	2,259
Commercial:		
Commercial term	2,300	2,100
Commercial construction	476	514
Consumer:		
Home equity	391	466
Other	167	245
Total non-accrual loans	5,546	7,499
Loans 90 days past due and still accruing	233	54
Total non-performing loans	5,779	7,553
Other real estate owned & other repossessed property	5,051	5,012
Total non-performing assets	\$ 10,830	\$ 12,565

The following tables summarize information in regards to impaired loans by loan portfolio class as of December 31, 2018 and December 31, 2017 and for the years then ended.

## Impaired Loans

(Dollars in thousands)	December 31, 2018			Average Recorded Investment	Interest Income Recognized
	Unpaid Recorded Investment	Principal Balance	Related Allowance		
With no related allowance recorded:					
Residential mortgage	\$ 1,462	\$ 1,804	\$ -	\$ 1,832	\$ 18
Acquired residential mortgage with credit deterioration	-	-	-	1	-
Commercial mortgage	1,532	1,780	-	2,388	49
Acquired commercial mortgage with credit deterioration	514	527	-	656	34
Commercial:					
Commercial term	1,343	1,845	-	1,701	-
Commercial construction	476	514	-	491	-



Consumer:					
Home equity	531	535	-	633	7
Other	156	205	-	169	1
Total	\$ 6,014	\$ 7,210	\$ -	\$ 7,871	\$ 109
With allowance recorded:					
Residential mortgage	\$ 73	\$ 73	\$ 1	\$ 44	\$ 2
Acquired residential mortgage with credit deterioration	-	-	-	-	-
Commercial mortgage	737	802	78	208	-
Acquired commercial mortgage with credit deterioration	-	-	-	-	-
Commercial:					
Commercial term	957	1,015	203	820	-
Commercial construction	-	-	-	-	-
Consumer:					
Home equity	-	-	-	-	-
Other	41	42	3	71	-
Total	\$ 1,808	\$ 1,932	\$ 285	\$ 1,143	\$ 2
Total:					
Residential mortgage	\$ 1,535	\$ 1,877	\$ 1	\$ 1,876	\$ 20
Acquired residential mortgage with credit deterioration	-	-	-	1	-
Commercial mortgage	2,269	2,582	78	2,596	49
Acquired commercial mortgage with credit deterioration	514	527	-	656	34
Commercial:					
Commercial term	2,300	2,860	203	2,521	-
Commercial construction	476	514	-	491	-
Consumer:					
Home equity	531	535	-	633	7
Other	197	247	3	240	1
Total	\$ 7,822	\$ 9,142	\$ 285	\$ 9,014	\$ 111

(Dollars in thousands)	December 31, 2017			Average Recorded Investment	Interest Income Recognized
	Recorded Investment	Unpaid Principal Balance	Related Allowance		
With no related allowance recorded:					
Residential mortgage	\$ 1,908	\$ 2,210	\$ -	\$ 1,540	\$ -
Acquired residential mortgage with credit deterioration	-	-	-	7	-
Commercial mortgage	2,809	3,207	-	2,180	15
Acquired commercial mortgage with credit deterioration	936	950	-	1,205	-
Commercial:					
Commercial term	1,743	2,253	-	1,131	-
Commercial construction	514	514	-	690	-
Consumer:					
Home equity	612	632	-	586	9
Other	117	117	-	106	-
Total	\$ 8,639	\$ 9,883	\$ -	\$ 7,445	\$ 24
With allowance recorded:					
Residential mortgage	\$ -	\$ -	\$ -	\$ 333	\$ -
Acquired residential mortgage with credit deterioration	7	26	3	4	-
Commercial mortgage	19	93	19	8	-
Acquired commercial mortgage with credit deterioration	-	-	-	-	-
Commercial:					
Commercial term	337	343	123	325	-
Commercial construction	-	-	-	89	-
Consumer:					
Home equity	-	-	-	-	-
Other	128	129	12	169	-
Total	\$ 491	\$ 591	\$ 157	\$ 928	\$ -
Total:					
Residential mortgage	\$ 1,908	\$ 2,210	\$ -	\$ 1,873	\$ -
Acquired residential mortgage with credit deterioration	7	26	3	11	-
Commercial mortgage	2,828	3,300	19	2,188	15
Acquired commercial mortgage with credit deterioration	936	950	-	1,205	-
Commercial:					
Commercial term	2,080	2,596	123	1,456	-
Commercial construction	514	514	-	779	-
Consumer:					
Home equity	612	632	-	586	9
Other	245	246	12	275	-
Total	\$ 9,130	\$ 10,474	\$ 157	\$ 8,373	\$ 24

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The following tables present the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within DNB's internal risk rating system as of December 31, 2018 and December 31, 2017.

Credit Quality Indicators

(Dollars in thousands)	December 31, 2018				
	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage	\$ 97,577	\$ -	\$ 2,355	\$ -	\$ 99,932
Commercial mortgage	528,692	2,367	4,676	-	535,735
Commercial:					
Commercial term	161,051	1,178	4,106	-	166,335
Commercial construction	72,077	3,603	622	-	76,302
Consumer:					
Home equity	50,988	143	405	-	51,536
Other	4,924	-	207	-	5,131
Total	\$ 915,309	\$ 7,291	\$ 12,371	\$ -	\$ 934,971

(Dollars in thousands)	December 31, 2017				
	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage	\$ 91,993	\$ -	\$ 1,966	\$ -	\$ 93,959
Commercial mortgage	479,308	125	5,435	-	484,868
Commercial:					
Commercial term	125,926	115	3,494	-	129,535
Commercial construction	73,902	-	1,112	-	75,014
Consumer:					
Home equity	56,085	-	759	-	56,844
Other	5,432	-	245	-	5,677
Total	\$ 832,646	\$ 240	\$ 13,011	\$ -	\$ 845,897

Allowance for Credit Losses and Recorded Investment in Related Loans

The following tables set forth the activity and composition of DNB's allowance for credit losses at the dates and periods indicated.

	2018								
	Residential	Commercial	Commercial	Commercial	Lease	Consumer	Consumer		
(Dollars in thousands)	Mortgage	Mortgage	Term	Construction	Financing	Home Equity	Other	Unallocated	Total
Allowance for credit losses:									
Beginning balance - January 1, 2018	\$ 221	\$ 2,856	\$ 845	\$ 1,128	\$ -	\$ 183	\$ 63	\$ 547	\$ 5,843
Charge-offs	(178)	(249)	(243)	-	-	-	(72)	-	(742)
Recoveries	341	22	4	5	-	-	2	-	374
Provisions	(223)	1,018	456	(101)	-	7	53	(10)	1,200
Ending balance - December 31, 2018	\$ 161	\$ 3,647	\$ 1,062	\$ 1,032	\$ -	\$ 190	\$ 46	\$ 537	\$ 6,675
Ending balance: individually evaluated for impairment	\$ 1	\$ 78	\$ 203	\$ -	\$ -	\$ -	\$ 3	\$ -	\$ 285
Ending balance: collectively evaluated for impairment	\$ 160	\$ 3,569	\$ 859	\$ 1,032	\$ -	\$ 190	\$ 43	\$ 537	\$ 6,390
Ending balance: Loan receivables	\$ 99,932	\$ 535,735	\$ 166,335	\$ 76,302	\$ -	\$ 51,536	\$ 5,131		\$ 934,971
Ending balance: individually evaluated for impairment	\$ 1,535	\$ 2,269	\$ 2,300	\$ 476	\$ -	\$ 531	\$ 197		\$ 7,308
Ending balance: acquired with credit deterioration	\$ -	\$ 514	\$ -	\$ -	\$ -	\$ -	\$ -		\$ 514
Ending balance: collectively evaluated for impairment	\$ 98,397	\$ 532,952	\$ 164,035	\$ 75,826	\$ -	\$ 51,005	\$ 4,934		\$ 927,149



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	2017								
	Residential	Commercial	Commercial	Commercial	Lease	Consumer	Consumer		
(Dollars in thousands)	Mortgage	Mortgage	Term	Construction	Financing	Home Equity	Other	Unallocated	Total
Allowance for credit losses:									
Beginning balance - January 1, 2017	\$ 349	\$ 2,531	\$ 709	\$ 969	\$ -	\$ 196	\$ 61	\$ 558	\$ 5,373
Charge-offs	(85)	(519)	(683)	-	-	-	(38)	-	(1,325)
Recoveries	16	51	23	42	1	-	2	-	135
Provisions	(59)	793	796	117	(1)	(13)	38	(11)	1,660
Ending balance - December 31, 2017	\$ 221	\$ 2,856	\$ 845	\$ 1,128	\$ -	\$ 183	\$ 63	\$ 547	\$ 5,843
Ending balance: individually evaluated for impairment	\$ 3	\$ 19	\$ 123	\$ -	\$ -	\$ -	\$ 12	\$ -	\$ 157
Ending balance: collectively evaluated for impairment	\$ 218	\$ 2,837	\$ 722	\$ 1,128	\$ -	\$ 183	\$ 51	\$ 547	\$ 5,686
Ending balance: Loan receivables	\$ 93,959	\$ 484,868	\$ 129,535	\$ 75,014	\$ -	\$ 56,844	\$ 5,677		\$ 845,897
Ending balance: individually evaluated for impairment	\$ 1,908	\$ 2,828	\$ 2,080	\$ 514	\$ -	\$ 612	\$ 245		\$ 8,187
Ending balance: acquired with credit deterioration	\$ 7	\$ 936	\$ -	\$ -	\$ -	\$ -	\$ -		\$ 943
Ending balance: collectively evaluated for impairment	\$ 92,044	\$ 481,104	\$ 127,455	\$ 74,500	\$ -	\$ 56,232	\$ 5,432		\$ 836,767

The changes in the accretable yield of acquired loans accounted for under ASC 310-30 for the years ended December 31, 2018 and 2017 were as follows:

(Dollars in thousands)	2018	2017
Beginning balance, January 1	\$ 196	\$ 314

Reclassification of non-accretable discount	-	92
Accretion	(51)	(97)
Payments	-	(113)
Ending balance, December 31	\$ 145	\$ 196

## (5) OFFICE PROPERTY AND EQUIPMENT

(Dollars in thousands)	Estimated Useful Lives	December 31	
		2018	2017
Land		\$ 840	\$ 840
Buildings and leasehold improvements	5-31.5 years	13,129	13,063
Furniture, fixtures and equipment	2-20 years	16,811	16,658
Total cost		30,780	30,561
Less accumulated depreciation		(23,144)	(21,912)
Office property and equipment, net		\$ 7,636	\$ 8,649

Amounts charged to furniture and equipment for depreciation amounted to \$1.2 million for both years ended December 31, 2018 and 2017.

The Bank leases office space from Headwaters Associates (“Headwaters”), a Pennsylvania general partnership for which Mary D. Latoff (a director of DNB and the sole beneficiary of the Marital Trust created under Will of William S. Latoff), has been one of two general partners since January 1, 2017. Pursuant to the terms of the Lease, the Bank paid Headwaters an aggregate of \$496,000 in 2018, and \$530,000 in 2017. As a general partner of Headwaters, Mary Latoff received \$248,000 and \$265,000 in 2018 and 2017, respectively, as a result of the lease.

## (6) DEPOSITS

Included in interest bearing time deposits are time and brokered time deposit issued in amounts of \$250,000 or more totaling \$48.3 million and \$59.5 million at December 31, 2018 and 2017, respectively. These certificates and their remaining maturities at December 31, 2018 were as follows:

	December 31, 2018		
	Time	Brokered	
(Dollars in thousands)	Deposits	Time Deposits	Total
Three months or less	\$ 5,054	\$ -	\$ 5,054
Over three through six months	14,244	-	14,244
Over six through twelve months	18,514	-	18,514
Over one year through two years	9,321	-	9,321
Over two years	1,166	-	1,166
Total	\$ 48,299	\$ -	\$ 48,299

Time and brokered deposit scheduled to mature have the following remaining maturities:

	December 31, 2018		
	Time	Brokered	
(Dollars in thousands)	Deposits	Time Deposits	Total
One year or less	\$ 97,071	\$ 45,511	\$ 142,582
Over one year through two years	54,531	34,904	89,435
Over two years through three years	2,281	13,224	15,505
Over three years through four years	1,935	5,000	6,935
Over four years through five years	6,278	-	6,278
Over five years	-	-	-
Total	\$ 162,096	\$ 98,639	\$ 260,735

At December 31, 2018 and 2017, deposits of related parties amounted to \$5.6 million and \$7.6 million, respectively. The aggregate amount of demand deposit overdrafts that were reclassified as loans was \$217,000 at December 31, 2018, compared to \$265,000 at December 31, 2017.

## (7) FHLBP ADVANCES AND SHORT-TERM BORROWED FUNDS

The schedule below provides a summary of short-term borrowings that consist of securities sold under agreements to repurchase, federal funds purchased with Atlantic Community Bankers Bank and other borrowings. Securities sold under agreements to repurchase are overnight borrowings between DNB and its commercial depositors and are subject to daily repricing. Federal Funds purchased from correspondent banks mature in one business day and reprice daily based on the Federal Funds rate. As of December 31, 2018, DNB's total availability under Federal Funds lines was \$60.0 million. Other short-term borrowings consist of credit available through the Federal Home Loan Bank of



Pittsburgh (FHLBP) and the Federal Reserve Discount Window. DNB maintains a line-of-credit (Open Repo Plus) with the FHLBP which is a revolving term commitment used on an overnight basis. The term of this commitment may not exceed 364 days and it reprices daily at market rates. Under terms of a blanket collateral agreement with the FHLBP, the line-of-credit and long term advances are secured by FHLBP stock and qualifying loan receivables, principally real estate secured loans. As of December 31, 2018 DNB's total availability was \$508.6 million with the FHLBP and availability at the Federal Reserve Discount Window is dependent upon the market value of the collateral delivered to the Federal Reserve at the time funds are borrowed.

The following table presents a summary of aggregate short-term borrowings as of and for the years ended December 31, 2018 and 2017.

	2018		2017	
(Dollars in thousands)	Repurchase Agreements	Federal Funds Purchased	Repurchase Agreements	Federal Funds Purchased
Amount outstanding at end of year	\$ -	\$ -	\$ 12,023	\$ 2,372
Weighted average interest rate at end of year	-	% -	% 0.20	% 1.75
Maximum amount outstanding at any month-end	\$ 14,160	\$ 5,233	\$ 17,028	\$ 2,372
Daily average amount outstanding	\$ 7,516	\$ 1,106	\$ 14,229	\$ 143
Weighted average interest rate for the year	0.20	% 1.92	% 0.20	% 1.22

Total other borrowings at December 31, 2018 and 2017 consist of amounts described above and the capital lease obligation in Note 8. At December 31, 2018, total other borrowings also included \$3.0 million representing purchased loans not yet funded.

Repurchase agreements accounted for as secured borrowings are shown in the following table.

(Dollars in thousands)	Overnight and Continuous	Up to 30 days	30 - 90 days	Greater than 90 days	Total
December 31, 2018					
Repurchase agreements and repurchase-to-maturity transactions	\$ -	\$ -	\$ -	\$ -	\$ -
Gross amount of recognized liabilities for repurchase agreements in statement of condition	\$ -				\$ -
December 31, 2017					
Repurchase agreements and repurchase-to-maturity transactions	\$ 12,023	\$ -	\$ -	\$ -	\$ 12,023
Gross amount of recognized liabilities for repurchase agreements in statement of condition	\$ 12,023				\$ 12,023

As of December 31, 2017, DNB had \$12.0 million of repurchase agreements. In conjunction with these repurchase agreements, a fair value of \$12.1 million of state and municipal securities were sold on an overnight basis as of December 31, 2017, which represents 102% of the repurchase agreement amount.

In addition to short-term borrowings, DNB maintains borrowing arrangements with the FHLBP to meet borrowing needs exceeding 30 days. The advances are collateralized by loans, and a lien on the Bank's FHLBP stock. There were \$719.4 million in loans used as collateral for FHLBP borrowings. After a collateral weighting of 70.70%, DNB's maximum borrowing capacity totaled \$508.6 million. In addition to the \$32.9 million of borrowings from the FHLBP at December 31, 2018, the FHLBP had issued letters of credit, on DNB's behalf, totaling \$30.0 million against DNB's available credit lines. These letters of credit were used to secure public deposits as required by law.

(Dollars in thousands)	December 31, 2018		December 31, 2017	
	Weighted Average Rate	Amount	Weighted Average Rate	Amount
Due by December 31, 2018	- %	\$ -	1.30 %	\$ 46,078
Due by December 31, 2019	1.43	14,592	1.43	14,592
Due by December 31, 2020	1.64	11,343	1.64	11,343
Due by December 31, 2021	-	-	-	-
Due by December 31, 2022	2.04	7,000	2.04	7,000
Total	1.63 %	\$ 32,935	1.44 %	\$ 79,013



## (8) LEASES

Included in other borrowings is a long-term capital lease agreement, which relates to DNB's West Goshen branch. As of December 31, 2018 the capital lease has a carrying amount of \$103,000 net of accumulated depreciation of \$647,000, and is included in the balance of office properties and equipment in the accompanying statements of financial condition. The following is a schedule of the future minimum capital lease payments, together with the present value of the net minimum lease payments, as of December 31, 2018:

(Dollars in thousands)	Year ended December 31
2019	\$ 107
2020	106
2021	107
2022	69
2023	-
Thereafter	-
Total minimum lease payments	389
Less amount representing interest	(84)
Present value of net minimum lease payments	\$ 305

DNB recognized rent expense of \$1.1 million and \$1.2 million for the years ended December 31, 2018 and 2017, respectively. The following is a schedule of the future minimum non-cancelable operating lease payments for the Operations Center in Downtingtown and leased branches as of December 31, 2018.

(Dollars in thousands)	Year ended December 31
2019	\$ 1,047
2020	799
2021	633
2022	472
2023	197
Thereafter	-
Total minimum lease payments	\$ 3,148



(9) SUBORDINATED DEBENTURES AND NOTES

DNB has two issuances of junior subordinated debentures (the “debentures”) as follows. The majority of the proceeds of each issuance were invested in DNB’s subsidiary, to increase the Bank’s capital levels. The junior subordinated debentures issued in each case qualify as a component of capital for regulatory purposes. DNB Capital Trust I and II are special purpose Delaware business trusts, which are not consolidated.

DNB Capital Trust I

DNB’s first issuance of junior subordinated debentures was on July 20, 2001. This issuance of debentures are at floating rates and were issued to DNB Capital Trust I, a Delaware business trust in which DNB owns all of the common equity. DNB Capital Trust I issued \$5 million of floating rate (6 month Libor plus 3.75%, with a cap of 12%) capital preferred securities to a qualified institutional buyer. The proceeds of these securities were used by the Trust, along with DNB’s capital contribution, to purchase \$5,155,000 principal amount of DNB’s floating rate junior subordinated debentures. The preferred securities have been redeemable since July 25, 2006 and must be redeemed upon maturity of the debentures on July 25, 2031.

DNB Capital Trust II

DNB’s second issuance of junior subordinated debentures was on March 30, 2005. This issuance of debentures are at floating rates and were issued to DNB Capital Trust II, a Delaware business trust in which DNB owns all of the common equity. DNB Capital Trust II issued \$4.0 million of floating rate (the rate was fixed at 6.56% for the first 5 years and is now adjusting at a rate of 3-month LIBOR plus 1.77%) capital preferred securities. The proceeds of these securities were used by the Trust, along with DNB’s capital contribution, to purchase \$4,124,000 principal amount of DNB’s floating rate junior subordinated debentures. The preferred securities have been redeemable since May 23, 2010. The preferred securities must be redeemed upon maturity of the debentures on May 23, 2035.

Subordinated Note

On March 5, 2015, DNB Financial Corporation entered into a Subordinated Note Purchase Agreement (the “Agreement”) with an accredited investor under which the Company issued a \$9.75 million subordinated note (the “Note”) to the investor. The Note has a maturity date of March 6, 2025, and bears interest at a fixed rate of 4.25% per annum for the first 5 years and then will float at the Wall Street Journal Prime rate plus 1.00%, provided that the interest rate applicable to the outstanding principal balance will at no time be less than 3.0% or greater than 5.75% per annum.

DNB may, at its option, beginning with the first interest payment date after March 6, 2019, and on any interest payment date thereafter, redeem the Note, in whole or in part, at par plus accrued and unpaid interest to the date of redemption. The Note is not subject to repayment at the option of the noteholder.

The Note is unsecured and ranks junior in right of payment to DNB’s senior indebtedness and to DNB’s obligations to its general creditors and qualifies as Tier 2 capital for regulatory purposes.



## (10) FAIR VALUES

FASB ASC Topic 820, Fair Value Measurements and Disclosures, establishes a fair value hierarchy based on the nature of data inputs for fair value determinations, under which DNB is required to value each asset within its scope using assumptions that market participations would utilize to value that asset. When DNB uses its own assumptions, it is required to disclose additional information about the assumptions used and the effect of the measurement on earnings or the net change in assets for the period.

The three levels of the fair value hierarchy under FASB ASC Topic 820 are as follows:

Level 1—Quoted prices in active markets for identical securities.

Level 2—Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active and model derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3—Instruments whose significant value drivers are unobservable.

A description of the valuation methodologies used for assets measured at fair value is set forth below:

DNB's available-for-sale investment securities, which generally include U.S. government agencies and mortgage backed securities, collateralized mortgage obligations, corporate bonds, asset-backed securities, and state and municipal tax-exempt securities are reported at fair value. These securities are valued by an independent third party ("preparer"). The preparer's evaluations are based on market data. They utilize evaluated pricing models that vary by asset and incorporate available trade, bid and other market information. For securities that do not trade on a daily basis, their evaluated pricing applications apply available information such as benchmarking and matrix pricing. The market inputs normally sought in the evaluation of securities include benchmark yields, reported trades, broker/dealer quotes (only obtained from market makers or broker/dealers recognized as market participants), issuer spreads, two-sided markets, benchmark securities, bid, offers and reference data. For certain securities additional inputs may be used or some market inputs may not be applicable. Inputs are prioritized differently on any given day based on market conditions.

U.S. Government agencies are evaluated and priced using multi dimensional relational models and option adjusted spreads. State and municipal securities are evaluated on a series of matrices including reported trades and material event notices. Mortgage backed securities are evaluated using matrix correlation to treasury or floating index benchmarks, prepayment speeds, monthly payment information and other benchmarks. Other investments are evaluated using a broker quote based application, including quotes from issuers.

Impaired loans are those loans that the Bank has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

OREO assets are adjusted to fair value less estimated selling costs upon transfer of the loans to OREO. Subsequently, OREO assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. These assets are included as level 3 fair values.





The following table summarizes the assets at December 31, 2018 and December 31, 2017 that are recognized on DNB's balance sheet using fair value measurement determined based on the differing levels of input.

(Dollars in thousands)	December 31, 2018			Assets at Fair Value
	Level 1	Level 2	Level 3	
Assets Measured at Fair Value on a Recurring Basis				
US Government agency obligations	\$ -	\$ 47,723	\$ -	\$ 47,723
GSE mortgage-backed securities	-	26,558	-	26,558
Collateralized mortgage obligations GSE	-	9,808	-	9,808
Corporate bonds	-	10,704	-	10,704
State and municipal tax-exempt	-	1,850	-	1,850
Total assets measured at fair value on a recurring basis	\$ -	\$ 96,643	\$ -	\$ 96,643
Assets Measured at Fair Value on a Nonrecurring Basis				
Impaired loans	\$ -	\$ -	\$ 1,523	\$ 1,523
OREO & other repossessed property	-	-	1,247	1,247
Total assets measured at fair value on a nonrecurring basis	\$ -	\$ -	\$ 2,770	\$ 2,770

(Dollars in thousands)	December 31, 2017			Assets at Fair Value
	Level 1	Level 2	Level 3	
Assets Measured at Fair Value on a Recurring Basis				
US Government agency obligations	\$ -	\$ 52,893	\$ -	\$ 52,893
GSE mortgage-backed securities	-	32,488	-	32,488
Collateralized mortgage obligations GSE	-	11,654	-	11,654
Corporate bonds	-	12,820	-	12,820
State and municipal tax-exempt	-	1,928	-	1,928
Total assets measured at fair value on a recurring basis	\$ -	\$ 111,783	\$ -	\$ 111,783
Assets Measured at Fair Value on a Nonrecurring Basis				
Impaired loans	\$ -	\$ -	\$ 1,814	\$ 1,814
OREO & other repossessed property	-	-	817	817
Total assets measured at fair value on a nonrecurring basis	\$ -	\$ -	\$ 2,631	\$ 2,631

The following table presents additional information about assets measured at fair value on a nonrecurring basis and for which DNB has utilized Level 3 inputs to determine fair value:

Quantitative Information about Level 3 Fair Value Measurement  
December 31, 2018

(Dollars in thousands)	Fair Value Estimate	Valuation Techniques	Range (Weighted Unobservable Input Average)
Impaired loans - Residential mortgage	\$ 72	Appraisal of collateral (1)Disposal costs (2)	-8% to -8% (-8%)
Impaired loans - Commercial mortgage	659	Appraisal of collateral (1)Disposal costs (2)	-14% to -14% (-14%)
Impaired loans - Commercial term	754	Appraisal of collateral (1)Disposal costs (2)	0% to -16% (-11%)
Impaired loans - Consumer other	38	Appraisal of collateral (1)Disposal costs (2)	-8% to -8% (-8%)
Impaired loan total	\$ 1,523		
Other real estate owned	\$ 1,247	Disposal costs (2)	-8% to -8% (-8%)

Quantitative Information about Level 3 Fair Value Measurement  
December 31, 2017

(Dollars in thousands)	Fair Value Estimate	Valuation Techniques	Range (Weighted Unobservable Input Average)
Impaired loans - Residential mortgage	\$ 4	Appraisal of collateral (1)Disposal costs (2)	-8% to -8% (-8%)
Impaired loans - Commercial mortgage	46	Appraisal of collateral (1)Disposal costs (2)	-8% to -8% (-8%)
Impaired loans - Commercial term	1,648	Appraisal of collateral (1)Disposal costs (2)	0% to -9% (-8%)
Impaired loans - Consumer other	116	Appraisal of collateral (1)Disposal costs (2)	-8% to -8% (-8%)
Impaired loan total	\$ 1,814		
Other real estate owned	\$ 817	Disposal costs (2)	-8% to -8% (-8%)

(1) Fair value is generally determined through independent appraisals or sales contracts of the underlying collateral, which generally include various level 3 inputs which are not identifiable.

(2) Appraisals are adjusted by management for qualitative factors, such as economic conditions and estimated disposal costs.

Impaired loans. Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of \$7.8 million at December 31, 2018. Of this, \$1.8 million had specific valuation allowances of \$285,000, leaving a fair value of \$1.5 million as of December 31, 2018. DNB did not have any impaired loans that were partially charged down that didn't already have a specific reserve during the year ended December 31, 2018. The total fair value of impaired loans at December 31, 2018 was \$1.5 million.

Impaired loans had a carrying amount of \$9.1 million at December 31, 2017. Of this, \$491,000 had specific valuation allowances of \$157,000, leaving a fair value of \$334,000 at December 31, 2017. In addition, DNB had \$1.9 million in impaired loans that were partially charged down by \$442,000, leaving \$1.5 million at fair value as of December 31, 2017. The total fair value of impaired loans at December 31, 2017 was \$1.8 million.

**Other Real Estate Owned & other repossessed property** Other real estate owned (“OREO”) consists of properties acquired as a result of, or in-lieu-of, foreclosure. Properties or other assets are classified as OREO and other repossessed property are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying value or fair value, less estimated costs to sell. Costs relating to the development or improvement of the assets are capitalized and costs relating to holding the assets are charged to expense. DNB had \$5.1 million of such assets at December 31, 2018, which consisted of \$4.9 million in OREO and \$142,000 in other repossessed property. DNB had \$5.0 million of such assets at December 31, 2017, which consisted of \$4.8 million in OREO and \$177,000 in other repossessed property. Subsequent to the repossession of these assets, DNB wrote down the carrying values of certain assets totaling \$1.6 million by \$355,000 to \$1.2 million in OREO during the year ended December 31, 2018. DNB wrote down the carrying values of certain assets totaling \$956,000 by \$139,000 to \$817,000 in OREO during the year ended December 31, 2017.

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Below is management's estimate of the fair value of all financial instruments, whether carried at cost or fair value on DNB's consolidated balance sheet. The carrying amounts and estimated fair values of financial instruments at December 31, 2018 and December 31, 2017 are as follows:

(Dollars in thousands)	December 31, 2018				
	Carrying Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	\$ 17,321	\$ 17,321	\$ 17,321	\$ -	\$ -
AFS investment securities	96,643	96,643	-	96,643	-
HTM investment securities	62,026	61,135	-	59,135	2,000
Restricted stock	5,616	5,616	-	5,616	-
Loans held for sale	419	429	-	-	429
Loans, net of allowance, including impaired	928,296	914,822	-	-	914,822
Accrued interest receivable	4,207	4,207	-	4,207	-
Financial liabilities					
Deposits:					
Non-interest-bearing	164,746	164,746	-	164,746	-
NOW, Money market, and Savings	549,073	549,073	-	549,073	-
Time	162,096	160,944	-	160,944	-
Brokered	108,651	97,250	-	97,250	-
Repurchase agreements	-	-	-	-	-
FHLBP advances	32,935	32,347	-	32,347	-
Junior subordinated debentures and other borrowings	9,279	10,285	-	10,285	-
Subordinated debt	9,750	9,505	-	9,505	-
Accrued interest payable	646	646	-	646	-
Off-balance sheet instruments	-	-	-	-	-

(Dollars in thousands)	December 31, 2017				
	Carrying Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	\$ 10,917	\$ 10,917	\$ 10,917	\$ -	\$ -
AFS investment securities	111,783	111,783	-	111,783	-
HTM investment securities	62,390	62,420	-	60,420	2,000
Restricted stock	7,641	7,641	-	7,641	-
Loans held for sale	651	657	-	-	657
Loans, net of allowance, including impaired	840,054	821,672	-	-	821,672
Accrued interest receivable	3,822	3,822	-	3,822	-
Financial liabilities					
Deposits:					
Non-interest-bearing	176,815	176,815	-	176,815	-
NOW, Money market, and Savings	502,086	502,086	-	502,086	-
Time	140,490	139,406	-	139,406	-
Brokered	41,812	42,304	-	42,304	-
Repurchase agreements	12,023	12,023	-	12,023	-

FHLBP advances	79,013	78,531	-	78,531	-
Junior subordinated debentures and other borrowings	9,279	9,373	-	9,373	-
Subordinated debt	9,750	9,577	-	9,577	-
Accrued interest payable	554	554	-	554	-
Off-balance sheet instruments	-	-	-	-	-

The specific estimation methods and assumptions used can have a substantial impact on the resulting fair values of financial instruments. Following is a brief summary of the significant assumptions, methods, and estimates used in estimating fair value.

**Limitations** Fair value estimates are made at a specific point in time, based on relevant market information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time DNB's entire holdings of a particular financial instrument. Because no market exists for a significant portion of DNB's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

## (11) FEDERAL INCOME TAXES

Income tax expense was comprised of the following:

(Dollars in thousands)	Year Ended December 31	
	2018	2017
Current tax expense:		
Federal	\$ 2,035	\$ 3,121
State	8	6
Deferred income tax (benefit) expense:		
Federal	247	2,329
Income tax expense	\$ 2,290	\$ 5,456

The effective income tax rates of 17.65% for 2018 and 40.71% for 2017 were different than the applicable statutory Federal income tax rate of 21% for 2018 and 34% for 2017. The reason for these differences follows:

(Dollars in thousands)	Year Ended December 31	
	2018	2017
Federal income taxes at statutory rate	\$ 2,725	\$ 4,557
Decrease resulting from:		
Tax-exempt interest and dividend preference	(258)	(469)
Rate change	-	1,846
Stock Options	(112)	(331)
Bank owned life insurance	(47)	(145)
Other, net decrease	(18)	(2)
Income tax expense	\$ 2,290	\$ 5,456

The tax effects of temporary differences that give rise to deferred tax assets and deferred tax liabilities are presented below:

(Dollars in thousands)	December 31	
	2018	2017
Deferred tax assets:		
Allowance for credit losses	\$ 1,402	\$ 1,227
Unrealized losses on securities	446	372
Unrealized loss on pension obligation	344	388
Capital loss disallowance	2	2
State net operating losses	960	739
Unvested stock awards	45	70

Deferred compensation (SERP)	506	435
Nonqualified stock options	-	11
Pension	8	24
Non-accrued interest	197	501
Provision for unfunded loans	83	73
OREO write-downs	76	38
Core deposit intangible	11	11
Accrued expenses	-	57
Purchase accounting loan general credit mark	451	584
Purchase accounting loan specific credit mark	30	51
Purchase accounting loan interest rate mark	68	84
Purchase accounting CD rate mark	23	60
Purchase accounting term FHLBP advances	17	34
Organization costs	5	10
Total gross deferred tax assets	4,674	4,771
Deferred tax liabilities:		
Depreciation	(167)	(180)
Bank shares tax credit	(131)	(140)
Prepaid expenses	(219)	(173)
Mortgage servicing rights	(27)	(29)
Bad debt reserve	(67)	(117)
Purchase accounting core deposit intangible	(66)	(83)
Accrued expenses	(4)	-
Other reserves - reserve for unfunded	(4)	(6)
Purchase accounting deferred loan fees	(267)	(323)
Total gross deferred tax liabilities	(952)	(1,051)
Valuation allowance	(960)	(740)
Net deferred tax asset	\$ 2,762	\$ 2,980

As of December 31, 2018, DNB had no material unrecognized tax benefits or accrued interest and penalties. It is DNB's policy to account for interest and penalties accrued relative to unrecognized tax benefits as a component of income tax expense. Federal and state tax years 2015 through 2017 were open for examination as of December 31, 2018. The Company's financial results reflect the income tax effects of the Tax Cuts and Jobs Act for which the accounting under ASC Topic 740 is complete. On December 22, 2017, the Tax Cuts and Jobs Act was signed into law. The Act includes many provisions that will effect DNB's income tax expenses, including reducing the corporate federal tax rate from 34% to 21% effective January 1, 2018. As a result of the rate reduction, DNB was required



to re-measure, through income tax expense in the period of enactment, its deferred tax assets and liabilities using the enacted rate at which DNB expects them to be recovered or settled. The re-measurement of the net deferred tax asset resulted in additional income tax expense of \$1.8 million.

DNB had net state operating loss carryovers with the Commonwealth of Pennsylvania of \$11.4 million and \$10.5 million at December 31, 2018 and 2017, respectively for which a full valuation allowance has been established. These carryovers will begin to expire in 2021.

## (12) EARNINGS PER COMMON SHARE

Basic earnings per share (“EPS”) is computed based on the weighted average number of common shares outstanding during the period. Diluted EPS is computed using the treasury stock method and reflects the potential dilution that could occur from the exercise of stock options and the amortized portion of unvested stock awards. Stock options and unvested stock awards for which the exercise or the grant price exceeds the average market price over the period have an anti-dilutive effect on EPS and, accordingly, are excluded from the calculation. Treasury shares are not deemed outstanding for earnings per share calculations. There were no anti-dilutive stock options outstanding, and 9,200 anti-dilutive stock awards at December 31, 2018. There were no anti-dilutive stock options outstanding, and no anti-dilutive stock awards at December 31, 2017. The following table sets forth the computation of basic and diluted earnings per share:

(In thousands, except per share data)	Year Ended December 31					
	2018			2017		
	Income	Shares	Amount	Income	Shares	Amount
Basic EPS						
Net income available to common stockholders	\$ 10,684	4,303	\$ 2.48	\$ 7,946	4,260	\$ 1.87
Effect of potential dilutive common stock equivalents - stock options and restricted shares	-	12	-	-	30	(0.02)
Diluted EPS						
Income available to common stockholders after assumed exercises	\$ 10,684	4,315	\$ 2.48	\$ 7,946	4,290	\$ 1.85

## (13) BENEFIT PLANS

**Pension Plan** The Bank maintains a defined benefit pension plan (the “Plan”) covering all employees, including officers, who have been employed for one year and have attained 21 years of age. Prior to May 1, 1985, an individual must have attained the age of 25 and accrued one year of service. The Plan provides pension benefits to eligible retired employees at 65 years of age equal to 1.5% of their average monthly pay multiplied by their years of accredited

service (maximum 40 years). The accrued benefit is based on the monthly average of their highest five consecutive years of their last ten years of service. The Plan generally covers only full-time employees.

Effective December 31, 2003, DNB amended its Plan to curtail future eligibility and so that no participants will earn additional benefits under the Plan after December 31, 2003. As a result of this amendment, no further service or compensation was credited under the Plan after December 31, 2003. The Plan, although frozen, will continue to provide benefit payments and eligible employees can still earn vesting credits until retirement.

The following table summarizes the changes in the fair value of plan assets, changes in the projected benefit obligation (PBO), the funded status of both the accumulated benefit obligation (ABO) and the PBO, and the weighted-average assumptions used to determine benefit obligations for the pension plan at December 31, 2018 and 2017. Amounts recognized at December 31, 2018 and 2017 are reflected in other assets, and in accrued expenses and other liabilities on the Consolidated Statements of Financial Condition. The estimation of DNB's PBO associated with these plans considers various actuarial assumptions for mortality rates and discount rates.

The following table sets forth the Plan's funded status, as of the measurement dates of December 31, 2018 and 2017 and amounts recognized in DNB's consolidated financial statements at December 31, 2018 and 2017:

(Dollars in thousands)	December 31	
	2018	2017
Projected benefit obligation	\$ (6,133)	\$ (6,925)
Accumulated benefit obligation	(6,133)	(6,925)
Fair value of plan assets	4,457	4,960
Amounts recognized in the statement of financial condition consist of:		
Other liabilities	\$ (1,676)	\$ (1,965)
Funded status	\$ (1,676)	\$ (1,965)
Amounts recognized in accumulated other comprehensive loss consist of:		
Net loss	\$ 1,637	\$ 1,849
Total	\$ 1,637	\$ 1,849

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The amounts and changes in DNB's pension benefit obligation and fair value of plan assets for the years ended December 31, 2018 and 2017 are as follows:

	Year ended December 31	
(Dollars in thousands)	2018	2017
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 6,925	\$ 6,695
Interest cost	241	262
Actuarial (gain) loss	(567)	603
Benefits paid	(466)	(635)
Benefit obligation at end of year	\$ 6,133	\$ 6,925
Change in plan assets		
Fair value of assets at beginning of year	\$ 4,960	\$ 4,887
Actual return on plan assets	(226)	575
Employer contribution	267	211
Benefits paid	(466)	(635)
Estimated expenses	(78)	(78)
Fair value of assets at end of year	\$ 4,457	\$ 4,960

The Plan's assets are invested using an asset allocation strategy in units of certain equity, bond, real estate and money market funds. The following table summarizes the weighted average asset allocations as of the dates indicated:

	December 31			
	2018		2017	
Cash and cash equivalents	4.9	%	3.3	%
Equity securities	48.3		53.1	
Fixed income securities	46.8		43.6	
Total	100.0	%	100.0	%

Equity securities consist mainly of equity common trust funds and mutual funds. Fixed income securities consist mainly of fixed income common trust funds. Pension plan assets are invested with a moderate growth objective, with target asset allocations of approximately 50 - 60% bonds and cash and approximately 40 - 50% in stocks. As of December 31, 2018, the plan held 51.7% of its assets in bonds and cash.

Net periodic pension costs for the years indicated include the following components:

	Year Ended December 31	
(Dollars in thousands)	2018	2017
Service cost	\$ 80	\$ 65

Interest cost	241	262
Expected return on plan assets	(267)	(257)
Recognized net actuarial loss*	136	133
Recognized actuarial loss due to settlements	-	106
Net periodic cost	\$ 190	\$ 309
Assumptions used:		
Discount rate:		
Obligation	4.22 %	3.61 %
Expense	3.61	4.09
Rate of increase in compensation level	N/A	N/A
Expected long-term rate of return on assets	5.50	5.50

\*Amounts are included in "Salaries and employee benefits" in the consolidated statements of income.

In selecting the expected long-term rate of return on assets used for the Plan, DNB considered the average rate of earnings expected on the funds invested or to be invested to provide for the benefits of the Plan. This included considering the asset allocation and the expected returns likely to be earned over the life of the plan. This basis is consistent with the prior year. The discount rate is the rate used to determine the present value of DNB's future benefit obligations for its pension. The projected benefit obligation at December 31, 2018 and 2017 was determined using a variation of the RP-2014 mortality tables published by the Society of Actuaries.

DNB anticipates making contributions to the plan totaling \$305,000 in 2019. DNB's estimated future benefit payments are as follows:

(Dollars in thousands)	Period	Benefits
	2019	\$ 515
	2020	1,008
	2021	876
	2022	246
	2023	457
	2024-2028	1,726

The estimated components of net periodic benefit cost and other amounts recognized in other comprehensive income during the 2019 fiscal year are as follows:

(Dollars in thousands)	
Service cost	\$ 82
Interest cost	248
Expected return on plan assets	(239)
Amortization of net loss	126
Estimated 2019 net periodic benefit cost	\$ 217

The fair value of DNB's pension plan assets by asset category are as follows:

(Dollars in thousands)	December 31, 2018			Assets at Fair Value
	Level 1	Level 2	Level 3	
Mutual fund - equity:				
US equities	\$ 987	\$ -	\$ -	\$ 987
International equities	1,040	-	-	1,040
Real estate	126	-	-	126
Mutual funds - fixed income:				
Domestic fixed income	2,086	-	-	2,086
US corporate bonds, notes and cash:				
Cash	218	-	-	218
Total assets measured at fair value on a recurring basis	\$ 4,457	\$ -	\$ -	\$ 4,457

(Dollars in thousands)	December 31, 2017			Assets at Fair Value
	Level 1	Level 2	Level 3	
Mutual fund - equity:				
US equities	\$ 1,227	\$ -	\$ -	\$ 1,227
International equities	1,273	-	-	1,273
Real estate	133	-	-	133
Mutual funds - fixed income:				
Domestic fixed income	2,163	-	-	2,163
US corporate bonds, notes and cash:				
Cash	164	-	-	164
Total assets measured at fair value on a recurring basis	\$ 4,960	\$ -	\$ -	\$ 4,960

Retirement and Death Benefit Agreement During 1999, the Bank and Henry F. Thorne, its then current Chief Executive Officer (the “Executive”), entered into a Death Benefit Agreement providing for supplemental death and retirement benefits for him (the “Supplemental Plan”). In 2003, the Supplemental Plan was replaced by a Retirement and Death Benefit Agreement (the “Replacement Plan”).

The Replacement Plan provides that the Bank and the Executive share in the rights to the cash surrender value and death benefits of a split-dollar life insurance policy (the “Policy”). The policy is designed to provide the Executive, upon attaining age 65, with projected annual after-tax payments of approximately \$35,000. In addition, the Policy is intended to provide the Executive with a projected death benefit of \$750,000.

In July 2008, DNB commenced making monthly payments of \$3,658 to the Executive. The remaining liability under the plan was \$737,000 and \$738,000 as of December 31, 2018 and 2017, respectively. The annual expense for the same respective periods was \$58,000 and \$57,000.

Supplemental Executive Retirement Plan for Chairman and Chief Executive Officer (William S. Latoff passed away on January 11, 2016) DNB has an unfunded Supplemental Executive Retirement Plan (also known as a SERP) for its former Chairman and Chief Executive Officer, William S. Latoff. The purpose of the SERP was to provide Mr. Latoff a pension supplement beginning at age 70 to compensate him for the loss of retirement plan funding opportunities from his other business interests because of his commitments to DNB as Chairman and CEO. The liability based on the contract, which is included in “Other liabilities” on the statement of financial condition, is \$1.3 million at December 31, 2018. This amount will be paid out in 2019.

Supplemental Executive Retirement Plan for President & Chief Executive Officer and Chief Financial Officer DNB has an unfunded Supplemental Executive Retirement Plan (also known as a SERP) for William J. Hieb, DNB's President and Chief Executive Officer, and Gerald F. Sopp, DNB's Executive Vice President, Chief Financial Officer and Corporate Secretary (each, a "SERP," and collectively, the "SERPs"). The SERPs contain identical terms. Accordingly, each of Mr. Hieb and Mr. Sopp shall be referred to as the "Executive" below. Pursuant to the SERP, in the event that the Executive remains continuously employed by DNB until his 67th birthday, DNB shall pay to him a monthly retirement benefit for 180 months commencing on the first day of the first month following his 67th birthday. The monthly retirement benefit will be 2.5% of the average of the sum of the Executive's base salary and cash bonuses paid to him during the three calendar years ending immediately prior to his 67th birthday, except that the base salary for any year shall never be less than the base salary in effect on October 25, 2017. DNB's liability to Mr. Hieb's and Mr. Sopp's SERP was \$228,000 and \$183,000, respectively at December 31, 2018, compared to \$39,000 and \$32,000, respectively at December 31, 2017.

**401(k) Retirement Savings Plan** The Bank has adopted a retirement savings 401(k) plan. Participants are permitted to authorize pre-tax savings contributions to a separate trust established under the 401(k) plan, subject to limitations on deductibility of contributions imposed by the Internal Revenue Code. The plan allows after-tax contributions to be made as well. The contributions are subject to the same limitations. Management evaluates discretionary matching contributions each quarter based upon DNB's financial performance. DNB made no matching contributions to the 401(k) plan in 2018 and 2017.

**Profit Sharing Plan** The Bank maintains a Profit Sharing Plan for eligible employees. The plan provides that the Bank make contributions equal to 3% of the eligible participant's W-2 wages. DNB's related expense associated with the Profit Sharing Plan was \$392,000 and \$376,000 in 2018 and 2017, respectively.

**Stock Option Plan** DNB has a Stock Option Plan for employees and directors. Under the plan, options (both qualified and non-qualified) to purchase a maximum of 793,368 (as adjusted for subsequent stock dividends) shares of DNB's common stock could be issued to employees and directors.

Under the plan, option exercise prices must equal the fair market value of the shares on the date of option grant and the option exercise period may not exceed ten years. Vesting of options under the plan is determined by the Plan Committee. There were 354,090 shares available for grant at December 31, 2018 and 2017. All options currently outstanding are immediately exercisable. DNB fully recorded all stock option expense by the end of 2014. DNB had no stock option expense in 2018 or 2017.

The award agreement provides that, upon issuance of the plan shares, the grantee may elect to pay federal withholding taxes on the award in cash or by electing to apply some of the awarded shares at their fair market value, or both. Under the Stock Option Plan, 16,450 shares were exercised in 2018. The shares awarded from the non-qualified cashless exercises resulted in an increase in shares outstanding of 7,798. There was a cash equivalent of 8,652 shares used to pay all applicable taxes on the transactions. Under the Stock Option Plan, 33,250 shares were exercised in 2017. The shares awarded from the non-qualified cashless exercises resulted in an increase in shares outstanding of 14,748. There was a cash equivalent of 18,502 shares used to pay all applicable taxes on the transactions. Stock option activity is indicated in the following table:

	Number	Weighted Average Exercise Price
Outstanding January 1, 2017	49,700	\$ 9.18
Issued	-	-
Exercised	(33,250)	8.63
Forfeited	-	-
Expired	-	-
Outstanding December 31, 2017	16,450	\$ 10.31
Issued	-	-
Exercised	(16,450)	10.31
Forfeited	-	-
Expired	-	-
Outstanding December 31, 2018	-	\$ -

The weighted average price and weighted average remaining contractual life for the outstanding options are listed below for the dates indicated.

December 31, 2017

Range of Exercise Prices	Number Outstanding	Number Exercisable	Weighted Average Exercise Price	Remaining Contractual Life	Intrinsic Value
\$ 6.93-10.99	16,450	16,450	\$ 10.31	0.95 years	\$ 385,000



**Other Stock Based Compensation** DNB maintains an Incentive Equity and Deferred Compensation Plan. The plan provides that up to 493,101 shares of common stock may be granted, at the discretion of the Board, to individuals of DNB. Shares already granted are issuable on the earlier of three years or four years after the date of the grant or a change in control of DNB if the recipients are then employed by DNB (“Vest Date”). For awards granted prior to December 2016, upon issuance of the shares, resale of the shares is restricted for an additional one year, during which the shares may not be sold, pledged or otherwise disposed of. Prior to the Vest Date and in the event the recipient terminates association with DNB for reasons other than death, disability or change in control, the recipient forfeits all rights to the shares that would otherwise be issued under the grant.

Share awards granted by the plan were recorded at the date of award based on the fair market value of shares. Awards are being amortized to expense over a three or four-year cliff-vesting period. Restricted stock awards are non-participating shares.

For the twelve month periods ended December 31, 2018 and 2017, \$315,000 and \$559,000 was amortized to expense.

DNB issued 3,000 restricted stock awards during the first quarter of 2016 that required the award recipient to hold the shares for one additional year after vesting. These awards cliff vest in three years. For these shares, DNB adopted the Chaffe Model to measure the fair value by applying a 9.1% discount due to the lack of marketability when these transactions took place. The input assumptions used and resulting fair values were an expected life of 5 years, volatility of 19.37%, annual rate of quarterly dividends of 1.01%, and bond equivalent yield of 1.742%. DNB did not use the Chaffe Model on restricted stock awards issued during the years ended December 31, 2018 and 2017.

During the year ended December 31, 2018, DNB had \$112,000 of tax benefits for stock option exercises and restricted stock vesting. In accordance with ASU 2016-09, forfeitures are recognized as they occur instead of applying an estimated forfeiture rate to each grant. For purposes of the determination of stock-based compensation expense for the year ended December 31, 2018, we recognized actual forfeitures of 5,595 shares of restricted stock awards that were granted to officers and other employees.

At December 31, 2018, approximately \$294,000 in additional compensation will be recognized over the weighted average remaining service period of approximately 1.48 years. At December 31, 2018, 309,504 shares were reserved for future grants under the plan. There were 17,695 restricted shares that vested in 2018. The shares awarded from the cashless exercises resulted in an increase in shares outstanding of 11,135. There was a cash equivalent of 6,560 shares used to pay all applicable taxes on the transactions. There were 24,915 restricted shares that vested in 2017. The shares awarded from the cashless exercises resulted in an increase in shares outstanding of 13,839. There was a cash equivalent of 11,076 shares used to pay all applicable taxes on these transactions. Stock grant activity is indicated in the following table.

Weighted  
Average

	Shares	Stock Price
Non-vested stock awards - January 1, 2017	55,775	\$ 25.63
Granted	500	34.00
Forfeited	(230)	22.92
Vested	(24,915)	24.69
Non-vested stock awards - December 31, 2017	31,130	\$ 26.53
Granted	10,750	33.98
Forfeited	(5,595)	29.00
Vested	(17,695)	25.67
Non-vested stock awards - December 31, 2018	18,590	\$ 30.90

(14) COMMITMENTS, CONTINGENT LIABILITIES AND OFF-BALANCE SHEET RISK

In the normal course of business, various commitments and contingent liabilities are outstanding, such as guarantees and commitments to extend credit, borrow money or act in a fiduciary capacity, which are not reflected in the consolidated financial statements. Management does not anticipate any significant losses as a result of these commitments.

DNB had outstanding stand-by letters of credit totaling \$2.3 million and unfunded loan and lines of credit commitments totaling \$190.8 million at December 31, 2018, of which, \$166.2 million were variable rate and \$24.6 million were fixed rate. The amount of reserve for unfunded loan commitments at December 31, 2018 was \$395,000. DNB had outstanding stand-by letters of credit totaling \$4.6 million and unfunded loan and lines of credit commitments totaling \$176.6 million at December 31, 2017, of which, \$164.9 million were variable rate and \$11.6 million were fixed rate. The amount of reserve for unfunded loan commitments at December 31, 2016 was \$348,000.

These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet. The exposure to credit loss in the event of non-performance by the party to the financial instrument for commitments to extend credit and stand-by letters of credit is represented by the contractual amount. Management uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Stand-by letters of credit are conditional commitments issued by DNB to guarantee the performance or repayment of a financial obligation of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risks involved in issuing letters of credit are essentially the same as those involved in extending loan facilities to customers. DNB holds various forms of collateral to support these commitments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. DNB evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral, if any, obtained upon the extension of credit, usually consists of real estate, but may include securities, property or other assets.

DNB maintains borrowing arrangements with correspondent banks and the FHLBP, as well as access to the discount window at the Federal Reserve Bank of Philadelphia to meet short-term liquidity needs. Through these relationships, DNB has available credit of approximately \$568.6 million.

Assets held by DNB First Wealth Management in a fiduciary, custody or agency capacity at December 31, 2018 totaled \$253.3 million. These assets are not assets of DNB, and are not included in the consolidated financial statements.

DNB is a party to a number of lawsuits arising in the ordinary course of business. While any litigation causes an element of uncertainty, management is of the opinion that the liability, if any, resulting from the actions, will not have a material effect on the accompanying financial statements.

## (15) PARENT COMPANY FINANCIAL INFORMATION

Condensed financial information of DNB Financial Corporation follows:

Condensed Statements of Financial Condition	December 31	
(Dollars in thousands)	2018	2017
Assets		
Cash	\$ 229	\$ 114
Investment in subsidiary	130,333	120,530
Other assets	473	457
Total assets	\$ 131,035	\$ 121,101
Liabilities and Stockholders' Equity		
Liabilities		
Junior subordinated debentures	\$ 9,279	\$ 9,279
Subordinated debt	9,750	9,750
Other liabilities	160	130
Total liabilities	19,189	19,159
Stockholders' equity	111,846	101,942
Total liabilities and stockholders' equity	\$ 131,035	\$ 121,101

Condensed Statements of Income	Year Ended	
(Dollars in thousands)	December 31	
	2018	2017
Income:		
Equity in undistributed income of subsidiary	\$ 9,913	\$ 8,496
Dividends from subsidiary	1,650	250
Total income	11,563	8,746
Expense:		
Interest expense	879	800
Total expense	879	800
Net income	\$ 10,684	\$ 7,946
right		

Year Ended

Condensed Statements of Comprehensive Income		December 31	
(Dollars in thousands)		2018	2017
Net income		\$ 10,684	\$ 7,946
Other Comprehensive Income (Loss):			
Unrealized holding losses on AFS investment securities arising during the period			
Before tax amount	(350)	(117)	
Tax effect	73	40	
	(277)	(77)	
Accretion of discount on AFS to HTM reclassification			
Before tax amount(1)	-	8	
Tax effect(2)	-	(3)	
	-	5	
Less reclassification for gains on sales of AFS investment securities included in net income			
Before tax amount(3)	-	(9)	
Tax effect(2)	-	3	
	-	(6)	
Other comprehensive income (loss) - securities	(277)	(78)	
Unrealized actuarial gains (losses) - pension			
Before tax amount	212	(57)	
Tax effect	(45)	19	
	167	(38)	
Total other comprehensive loss	(110)	(116)	
Total comprehensive income		\$ 10,574	\$ 7,830

(1) Amounts are included in "Interest and dividends on investment securities" in the consolidated statements of income.

(2) Amounts are included in "Income tax expense" in the consolidated statements of income.

(3) Amounts are included in "Gains on sale of investment securities, net" in the consolidated statements of income.

Condensed Statements of Cash Flows (Dollars in thousands)	Year Ended December 31	
	2018	2017
Cash Flows From Operating Activities:		
Net income	\$ 10,684	\$ 7,946
Adjustments to reconcile net income to net cash used in operating activities:		
Equity in income of subsidiary and dividends	(11,563)	(8,746)
Stock based compensation	315	559
Non-cash funding of retirement plans	584	542
Dividends to holding company	1,650	250
Net change in other liabilities	30	11
Net change in other assets	(16)	27
Net Cash Provided by Operating Activities	1,684	589
Cash Flows From Financing Activities:		
Taxes on exercise of stock options	(365)	(635)
Dividends paid	(1,204)	(1,194)
Net Cash Used in Financing Activities	(1,569)	(1,829)
Net Change in Cash and Cash Equivalents	115	(1,240)
Cash and cash equivalents at Beginning of Period	114	1,354
Cash and cash equivalents at End of Period	\$ 229	\$ 114

(16) SELECTED QUARTERLY FINANCIAL DATA (Unaudited)

(Dollars in thousands, except share data)	2018				2017			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
RESULTS OF OPERATIONS								
Interest income	\$ 10,913	\$ 11,289	\$ 11,635	\$ 12,338	\$ 10,494	\$ 10,661	\$ 10,989	\$ 11,241
Interest expense	1,886	2,221	2,484	2,780	1,262	1,382	1,483	1,593
Net interest income	9,027	9,068	9,151	9,558	9,232	9,279	9,506	9,648
Provision for credit losses	375	375	100	350	325	585	375	375
Non-interest income	1,273	1,332	1,371	1,269	1,306	1,422	1,271	1,419
Non-interest expense	6,730	7,540	6,773	6,832	6,745	7,084	6,990	7,202
Income before income taxes	3,195	2,485	3,649	3,645	3,468	3,032	3,412	3,490
Income tax expense	582	436	629	643	1,027	746	1,001	2,682
Net income	\$ 2,613	\$ 2,049	\$ 3,020	\$ 3,002	\$ 2,441	\$ 2,286	\$ 2,411	\$ 808

PER SHARE DATA

Basic earnings*	\$ 0.61	\$ 0.48	\$ 0.70	\$ 0.70	\$ 0.57	\$ 0.54	\$ 0.57	\$ 0.19
Diluted earnings*	0.61	0.47	0.70	0.69	0.57	0.53	0.56	0.19
Cash dividends	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07

\*Earnings per share is computed independently for each period shown. As a result, the sum of the quarters may not equal the total earnings per share for the year.

## (17) REGULATORY MATTERS

Under the Federal Reserve's Regulation H, the Bank may not, without regulatory approval, declare or pay a dividend to DNB if the total of all dividends declared in a calendar year exceeds the total of (a) the Bank's net income for that year and (b) its retained net income for the preceding two calendar years, less any required transfers to additional paid-in capital or to a fund for the retirement of preferred stock.

In July of 2013, the respective U.S. federal banking agencies issued final rules implementing Basel III and the Dodd-Frank Act capital requirements that were fully phased in on a global basis on January 1, 2019. The new regulations establish a new tangible common equity capital requirement, increase the minimum requirement for the current Tier 1 risk-weighted asset ("RWA") ratio, phase out certain kinds of intangibles treated as capital and certain types of instruments and change the risk weightings of certain assets used to determine required capital ratios. The new common equity Tier 1 capital component requires capital of the highest quality – predominantly composed of retained earnings and common stock instruments. For community banks such as DNB First, National Association, a common equity Tier 1 capital ratio 4.5% became effective on January 1, 2015. The new capital rules also increased the current minimum Tier 1 capital ratio from 4.0% to 6.0% beginning on January 1, 2015. In addition, in order to make capital distributions and pay discretionary bonuses to executive officers without restriction, an institution must also maintain greater than 2.5% in common equity attributable to a capital conservation buffer to be phased in by 0.625% per year from January 1, 2016 until January 1, 2019. The new rules also increase the risk weights for several categories of assets, including an increase from 100% to 150% for certain acquisition, development and construction loans and more than 90-day past due exposures. The new capital rules maintain the general structure of the prompt corrective action rules, but incorporate the new common equity Tier 1 capital requirement and the increased Tier 1 RWA requirement into the prompt corrective action framework.

The Bank remains well capitalized under the implementation of Basel III, which was effective January 1, 2015. In assessing a bank's capital adequacy, regulators also consider other factors such as interest rate risk exposure; liquidity, funding and market risks; quality and level of earnings; concentrations of credit, quality of loans and investments; risks of any nontraditional activities; effectiveness of bank policies; and management's overall ability to monitor and control risks.

Quantitative measures established by regulation to ensure capital adequacy require DNB to maintain certain minimum amounts and ratios as set forth below. Based on management's assessment, DNB and the Bank meet all capital adequacy requirements to which they are subject. The Bank is considered "Well Capitalized" under the regulatory framework for prompt corrective action. To be categorized as Well Capitalized, the Bank must maintain minimum ratios as set forth below. There are no conditions or events since the most recent regulatory notification that management believes would have changed the Bank's category. Actual capital amounts and ratios are presented in the following table.

For Capital	To Be Well
Adequacy	Capitalized
	Under
	Prompt
	Corrective



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(Dollars in thousands)	Actual		Purposes*			Action Provisions*	
	Amount	Ratio	Amount	Ratio		Amount	Ratio
DNB Financial Corporation							
December 31, 2018:							
Total risk-based capital	\$ 124,769	13.61 %	\$ 73,538	8.00 %		N/A	N/A
Common equity tier 1 capital	98,949	10.79	41,365	4.50		N/A	N/A
Tier 1 risk-based capital	107,949	11.77	55,153	6.00		N/A	N/A
Tier 1 (leverage) capital	107,949	9.48	45,557	4.00		N/A	N/A
December 31, 2017:							
Total risk-based capital	\$ 113,400	13.73 %	\$ 66,083	8.00 %		N/A	N/A
Common equity tier 1 capital	88,459	10.71	37,172	4.50		N/A	N/A
Tier 1 risk-based capital	97,459	11.80	49,562	6.00		N/A	N/A
Tier 1 (leverage) capital	97,459	9.19	42,426	4.00		N/A	N/A
DNB First, N.A.							
December 31, 2018:							
Total risk-based capital	\$ 123,239	13.46 %	\$ 73,399	8.00 %	\$ 91,748	10.00 %	
Common equity tier 1 capital	116,169	12.69	41,287	4.50	59,636	6.50	
Tier 1 risk-based capital	116,169	12.69	55,049	6.00	73,399	8.00	
Tier 1 (leverage) capital	116,169	10.21	45,503	4.00	56,879	5.00	
December 31, 2017:							
Total risk-based capital	\$ 112,050	13.59 %	\$ 65,953	8.00 %	\$ 82,441	10.00 %	
Common equity tier 1 capital	105,859	12.84	37,098	4.50	53,587	6.50	
Tier 1 risk-based capital	105,859	12.84	49,465	6.00	65,953	8.00	
Tier 1 (leverage) capital	105,859	9.99	42,378	4.00	52,972	5.00	

\*Does not include capital conservation buffer of 1.250% for 2017 and 1.875% for 2018.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders

DNB Financial Corporation

Downingtown, Pennsylvania

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated statements of financial condition for DNB Financial Corporation and its subsidiaries (the “Corporation”) as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, changes in stockholders’ equity, and cash flows for each of the two years in the period ended December 31, 2018 and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Corporation and subsidiaries at December 31, 2018 and 2017, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) and our report dated March 14, 2019 expressed an unqualified opinion thereon.

Basis for Opinion

These consolidated financial statements are the responsibility of the Corporation’s management. Our responsibility is to express an opinion on the Corporation’s consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. 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, whether due to error or fraud.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ BDO USA, LLP

We have served as the Company's auditor since 2013.

Philadelphia, Pennsylvania

March 14, 2019

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

Item 9A. Controls and Procedures

- Evaluation of Disclosure Controls and Procedures

The Corporation carried out an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's Chief Executive Officer, William J. Hieb, and Chief Financial Officer, Gerald F. Sopp, of the effectiveness of the Corporation's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2018 pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Corporation's disclosure controls and procedures as of December 31, 2018 are effective.

- Changes in Internal Control over Financial Reporting

There were no changes in the Corporation's internal control over financial reporting during the fourth quarter of 2018 that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

- Design and Evaluation of Internal Control Over Financial Reporting

Pursuant to Section 404 of Sarbanes-Oxley, the following is a report of management's assessment of the design and effectiveness of our internal controls for the fiscal year ended December 31, 2018, and a report from our independent registered public accounting firm attesting to the effectiveness of our internal controls:

Management's Report on Internal Control Over Financial Reporting

The Corporation is responsible for the preparation, integrity, and fair presentation of the consolidated financial statements included in this Annual Report on Form 10-K. The consolidated financial statements and notes included in this Annual Report on Form 10-K have been prepared in conformity with United States generally accepted accounting principles and necessarily include some amounts that are based on Management's best estimates and judgments.

The Corporation's Management is responsible for establishing and maintaining effective internal control over financial reporting that is designed to produce reliable financial statements in conformity with United States generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Corporation; provide reasonable assurance that the transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles; provide a reasonable assurance that receipts and expenditures of the Corporation are only being made in accordance with authorizations of Management and directors of the Corporation; and provide a reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Corporation's assets that could have a material effect on the financial statements. The system of internal control over financial reporting as it relates to the financial statements is evaluated for effectiveness by Management and tested for reliability through a program of internal audits. Actions are taken to correct potential deficiencies as they are noted.

Any system of internal control, no matter how well designed, has inherent limitations, including the possibility that a control can be circumvented or overridden and misstatements due to error or fraud may occur and not be detected. Also, because of changes in conditions, internal control effectiveness may vary over time. Accordingly, even an effective system of internal control will provide only reasonable assurance with respect to financial statement preparation.

The Corporation's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Management, including the Corporation's Chief Executive Officer and Chief Financial Officer, assessed the Corporation's system of internal control over financial reporting as of December 31, 2018, in relation to the criteria for effective control over financial reporting as described in "Internal Control – Integrated Framework," issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013). Based on this assessment, Management concludes that, as of December 31, 2018, the Corporation's system of internal control over financial reporting is effective.

BDO USA, LLP, which is the independent registered public accounting firm that audited the financial statements for the year ended December 31, 2018 in this Annual Report on Form 10-K, has issued an attestation report on the Corporation's internal control over financial reporting, which can be found under the heading "Report of Independent Registered Public Accounting Firm", and is included herein.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders

DNB Financial Corporation

Downingtown, Pennsylvania

Opinion on Internal Control over Financial Reporting

We have audited DNB Financial Corporation and its subsidiaries (the “Corporation’s”) internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (the “COSO criteria”). In our opinion, the Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the consolidated statements of financial condition of the Corporation as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, changes in stockholders’ equity, and cash flows for each of the two years in the period ended December 31, 2018, and the related notes and our report dated March 14, 2019 expressed an unqualified opinion thereon.

Basis for Opinion

The Corporation’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A, Management’s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Corporation’s internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Corporation in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit of internal control over financial reporting in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ BDO USA, LLP

Philadelphia, Pennsylvania

March 14, 2019

Item 9B. Other Information

None

Part III

Item 10. Directors and Executive Officers of the Registrant

The information required for Item 10 is incorporated by reference to the sections titled “Information About our Directors,” “Corporate Governance,” “Audit Committee Report” and “Section 16(a) Beneficial Ownership Reporting Compliance” in the 2019 Proxy Statement.

Item 11. Executive Compensation

The information required for Item 11 is incorporated by reference to the sections titled “Director Compensation,” “Compensation Discussion and Analysis,” “Executive Compensation,” and “Benefits & Compensation Committee Report” in the 2019 Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

(a) Information Regarding Equity Compensation Plans

The following table summarizes certain information relating to equity compensation plans maintained by DNB as of December 31, 2018:

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted- average price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in first column)
Equity compensation plans approved by security holders:			
1995 Stock Option Plan	-	\$ -	354,090
2004 Incentive Equity and Deferred Compensation Plan	18,590	30.90	309,504
	-	-	-



Equity compensation plans not approved by security holders

Total	18,590	\$ 30.90	663,594
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(b)The balance of the information required is incorporated by reference to the section titled “Security Ownership of Certain Beneficial Owners and Management” and “Equity Compensation Plan Information” in the 2019 Proxy Statement.

#### Item 13. Certain Relationships and Related Party Transactions and Director Independence

The information required for Item 13 is incorporated by reference to the sections titled “Transactions with Related Persons” and “Corporate Governance – Director Independence” in the 2019 Proxy Statement.

#### Item 14. Principal Accountant Fees and Services

The information required for Item 14 is incorporated by reference to the section titled “Independent Registered Public Accounting Firm Fees” in the 2019 Proxy Statement.

Part IV

Item 15. Exhibits, Financial Statement Schedules.

(a)(1) Financial Statements.

The consolidated financial statements listed below, the report thereon, and the notes thereto, are set forth in this report under Item 8, "Financial Statements and Supplementary Data."

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(a)(2) Not applicable

(a)(3) Exhibits, pursuant to Item 601 of Regulation S-K.

The exhibits listed on the Index to Exhibits are incorporated by reference and filed or furnished herewith in response to this Item.

Item 16. Form 10-K Summary.

None

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DNB FINANCIAL CORPORATION

March 14, 2019

BY: /s/ William J. Hieb

William J. Hieb, Chief Executive Officer, President and Director (Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ James H. Thornton

James H. Thornton, Chairman of the Board

March 14, 2019

/s/ William J. Hieb

William J. Hieb, Chief Executive Officer, President and Director (Principal Executive Officer)

March 14, 2019

/s/ Gerald F. Sopp

Gerald F. Sopp, Chief Financial Officer

March 14, 2019

(Principal Financial Officer and Accounting Officer)

/s/ John F. McGill, Jr.

John F. McGill, Jr., Vice Chairman of the Board

March 14, 2019

/s/ Peter R. Barsz

Peter R. Barsz, Director

March 14, 2019

/s/ James R. Biery

March 14, 2019

James R. Biery, Director

/s/ Thomas A. Fillippo

March 14, 2019

Thomas A. Fillippo, Director

/s/ Gerard F. Griesser

March 14, 2019

Gerard F. Griesser, Director

/s/ Mildred C. Joyner

March 14, 2019

Mildred C. Joyner, Director

/s/ Mary D. Latoff

March 14, 2019

Mary D. Latoff, Director

/s/ Charles A. Murray

March 14, 2019

Charles A. Murray, Director

/s/ G. Daniel O'Donnell

March 14, 2019

G. Daniel O'Donnell, Director

Index to Exhibits

Exhibit No.  
Under Item 601  
of  
Regulation S-K

- 2 (i) Agreement and Plan of Merger by and between DNB Financial Corporation and East River Bank, dated as of April 4, 2016, filed as Exhibit 2.1 to Form 8-K on April 5, 2016 and incorporated herein by reference.
- 3 (i) Amended and Restated Articles of Incorporation, as amended effective June 30, 2017, filed as Exhibit 3.1 to Form 8-K on July 3, 2017 and incorporated herein by reference.  
(ii) Bylaws of the Registrant as amended January 27, 2016, filed as Exhibit 3.1 to Form 8-K on January 29, 2016 and incorporated herein by reference.
- 4 (a) Registrant has certain debt obligations outstanding, for none of which do the instruments defining holders rights authorize an amount of securities in excess of 10% of the total assets of the Registrant and its subsidiaries on a consolidated basis. Registrant agrees to furnish copies of such agreements to the Commission on request.  
(b) Subordinated Note, by and between DNB Financial Corporation and Jersey Shore State Bank, dated as of March 5, 2015, filed as Exhibit 4.1 to Form 8-K on March 5, 2015 and incorporated herein by reference.
- 10 (a)\* Amended and Restated Change of Control Agreements dated December 20, 2006 between DNB Financial Corporation and DNB First, N.A. and the following executive officers, each in the form filed March 26, 2007 as Exhibit 10(a) to Form 10-K for the fiscal year-ended December 31, 2006 and incorporated herein by reference: Bruce E. Moroney and C. Tomlinson Kline III.  
(b)\*\* 1995 Stock Option Plan of DNB Financial Corporation (as amended and restated, effective as of April 25, 2012), filed on March 22, 2012 as Appendix A to Registrant's Proxy Statement for its Annual Meeting of Shareholders held April 25, 2012 and incorporated herein by reference.  
(c)\*\* DNB Financial Corporation Incentive Equity and Deferred Compensation Plan (As Amended and Restated Effective April 26, 2017), filed March 27, 2017 as Appendix A to Registrant's Proxy Statement for its Annual Meeting of Shareholders held April 26, 2017 and incorporated herein by reference.  
(d)\* Agreement of Lease dated February 10, 2005 between Headwaters Associates, a Pennsylvania general partnership, as Lessor, and DNB First, National Association as Lessee for a portion of premises at 2 North Church Street, West Chester, Pennsylvania, filed March 10, 2005 as Exhibit 10(l) to Form 10-K for the fiscal year ended December 31, 2004 and incorporated herein by reference, as amended by Addendum to Agreement of Lease dated as of November 15, 2005, filed March 23, 2006 as Exhibit 10(l) to Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference, and as further amended by Second Addendum to Agreement of Lease dated as of May 25, 2006, filed August 14, 2006 as Exhibit 10(l) to Form 10-Q for the fiscal quarter ended June 30, 2006 and incorporated herein by reference, and as further amended by Third Addendum to Agreement of Lease dated as of June 9, 2010, filed August 13, 2010 as Exhibit 10(f) to Form 10-Q for the fiscal quarter ended June 30, 2010 and incorporated herein by reference and as further amended by Fourth Addendum to Agreement of Lease dated as of June 30, 2013, filed August 9, 2013 as Exhibit 10.1 to Form 10-Q for the fiscal quarter ended June 30, 2013 and incorporated herein by reference. This lease was further amended by the Amended and Restated Agreement of Lease on September 21, 2016, effective May 1, 2016, filed as Exhibit 10.1 to Form 8-K on September 23, 2016 and incorporated herein by reference.  
(e)\*\* Form of Stock Option Agreement for grants prior to 2005 under the Registrant's Stock Option Plan, filed May 11, 2005 as Exhibit 10(n) to Form 10-Q for the fiscal quarter ended March 31, 2005 and incorporated herein by reference.

- (f)\*\* Form of Nonqualified Stock Option Agreement for April 18, 2005 and subsequent grants prior to April 23, 2010 under the Stock Option Plan, filed May 11, 2005 as Exhibit 10(o) to Form 10-Q for the fiscal quarter ended March 31, 2005 and incorporated herein by reference.
  - (g)\* Amended and Restated Change of Control Agreement among DNB Financial Corporation, DNB First, N.A. and William J. Hieb, filed April 27, 2007 as Exhibit 10(l) to Form 10-K for the fiscal year ended December 31, 2006 and incorporated herein by reference.
  - (h)\*\* Form of Nonqualified Stock Option Agreement for grants on and after December 22, 2005 and prior to April 23, 2010 under the Stock Option Plan, filed March 23, 2006 as Exhibit 10(s) to Form 10-K for the fiscal year ended December 31, 2005 and incorporated herein by reference.
  - (i)\* Deferred Compensation Plan For Directors of DNB Financial Corporation (adopted effective October 1, 2006), filed November 14, 2006 as Exhibit 10(s) to Form 10-Q for the fiscal quarter ended September 30, 2006 and incorporated herein by reference.
  - (j)\* DNB Financial Corporation Deferred Compensation Plan (adopted effective October 1, 2006), filed November 14, 2006 as Exhibit 10(t) to Form 10-Q for the fiscal quarter ended September 30, 2006 and incorporated herein by reference.
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- (k)\* Change of Control Agreements among DNB Financial Corporation, DNB First, N.A. and Gerald F. Sopp, in the form filed March 26, 2007 as Exhibit 10(q) to Form 10-K for the fiscal year-ended December 31, 2006 and incorporated herein by reference.
- (l)\* DNB Financial Corporation Supplemental Executive Retirement Plan for William S. Latoff as amended and restated effective April 1, 2007, filed May 15, 2007 as Exhibit 10(r) to Form 10-Q for the fiscal quarter ended March 31, 2007 and incorporated herein by reference, as further amended by Amendment dated December 8, 2008, filed March 31, 2009 as Exhibit 3(r) to Form 10-K for the fiscal year-ended December 31, 2008 and incorporated herein by reference.
- (m)\* DNB Offer Letter to Gerald F. Sopp, dated December 20, 2006, filed March 26, 2007 as Exhibit 10(u) to Form 10-K for the fiscal year-ended December 31, 2006 and incorporated herein by reference.
- (n)\*\* Form of Restricted Stock Award Agreement dated November, 28, 2007, filed March 28, 2008 as Exhibit 10(v) to Form 10-K for the fiscal year-ended December 31, 2007 and incorporated herein by reference.
- (o)\*\* Form of Restricted Stock Option Agreement for non-employee directors for awards made on and after April 23, 2010 pursuant to the 1995 Stock Option Plan of DNB Financial Corporation (as amended and restated, effective as of April 27, 2004), filed August 13, 2010 as Exhibit 10(y) to Form 10-Q for the fiscal quarter ended June 30, 2010 and incorporated herein by reference.
- (p)\*\* Form of Restricted Stock Option Agreement for employees for awards made on and after April 23, 2010 pursuant to the 1995 Stock Option Plan of DNB Financial Corporation (as amended and restated, effective as of April 27, 2004), filed August 13, 2010 as Exhibit 10(z) to Form 10-Q for the fiscal quarter ended June 30, 2010 and incorporated herein by reference.
- (q)\* Form of Amendment effective April 23, 2010, to the Restricted Stock Award agreements made between James H. Thornton, James J. Koegel, Mildred C. Joyner and Thomas A. Fillippo, non-employee Directors of the registrant, and the registrant on November 28, 2007 and December 17, 2008, filed August 13, 2010 as Exhibit 10(aa) to Form 10-Q for the fiscal quarter ended June 30, 2010 and incorporated herein by reference.
- (r)\*\* Form of Amendment effective April 23, 2010, to the Restricted Stock Award agreements made between William J. Hieb, Gerald F. Sopp and Bruce E. Moroney, officers of the registrant, and the registrant on November 28, 2007 and December 17, 2008, filed August 13, 2010 as Exhibit 10(cc) to Form 10-Q for the fiscal quarter ended June 30, 2010 and incorporated herein by reference.
- (s)\* Form of Amendment to Change of Control Agreement For Named Executive Officers, filed as Exhibit 99.1 to Form 8-K on October 28, 2011 and incorporated herein by reference.
- (t)\*\* Form of Restricted Stock Award Agreement for Directors, filed as Exhibit 99.1 to Form 8-K on December 21, 2012 and incorporated herein by reference.
- (u)\*\* Form of Restricted Stock Award Agreement for employees, filed as Exhibit 99.2 to Form 8-K on December 21, 2012 and incorporated herein by reference.
- (v)\* Amended Change of Control Agreement among DNB Financial Corporation, DNB First, N.A. and Gerald F. Sopp, filed as Exhibit 99.3 to Form 8-K on December 21, 2012 and incorporated herein by reference.
- (w)\* Change of Control Agreement among DNB Financial Corporation, DNB First, N.A. and Vincent Liuzzi, filed August 11, 2014 as Exhibit 10.1 to Form 10-Q for the fiscal quarter ended June 30, 2014 and incorporated herein by reference.
- (x) Subordinated Note Purchase Agreement, by and between DNB Financial Corporation and Jersey Shore State Bank, dated as of March 5, 2015, filed as Exhibit 10.1 to Form 8-K on March 5, 2015 and incorporated herein by reference.
- (y)\* Amendment to Change of Control Agreement for William J. Hieb, filed as Exhibit 10.1 to Form 8-K on November 17, 2017 and incorporated herein by reference.
- (z)\*\* Amendment to Restricted Stock Award Agreements for William J. Hieb, filed as Exhibit 10.2 to Form 8-K on November 17, 2017 and incorporated herein by reference.
- (aa)\* Amendment to Change of Control Agreement for Gerald F. Sopp, filed as Exhibit 10.3 to Form 8-K on November 17, 2017 and incorporated herein by reference.



- (bb)\*\* Amendment to Restricted Stock Award Agreements for Gerald F. Sopp, filed as Exhibit 10.4 to Form 8-K on November 17, 2017 and incorporated herein by reference.
- (cc)\* DNB Financial Corporation Supplemental Executive Retirement Plan for William J. Hieb, filed as Exhibit 99.1 to Form 8-K on October 30, 2017 and incorporated herein by reference.
- (dd)\* DNB Financial Corporation Supplemental Executive Retirement Plan for Gerald F. Sopp, filed as Exhibit 99.2 to Form 8-K on October 30, 2017 and incorporated herein by reference.

10 Change of Control Agreement among DNB Financial Corporation, DNB First, N.A. and James A. Malloy, filed herewith.

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- 14      Code of Ethics as amended and restated effective October 25, 2017, filed March 15, 2018 as Exhibit 14 to Form 10-K for the fiscal year ended December 31, 2017 and incorporated herein by reference.
- 21      List of Subsidiaries, filed herewith.
- 23      Consent of BDO USA, LLP, filed herewith.
  
- 31.1    Rule 13a-14(a)/15d-14 (a) Certification of Chief Executive Officer, filed herewith.
- 31.2    Rule 13a-14(a)/15d-14 (a) Certification of Chief Financial Officer, filed herewith.
- 32.1    Section 1350 Certification of Chief Executive Officer, filed herewith.
- 32.2    Section 1350 Certification of Chief Financial Officer, filed herewith.
  
- 101.INS    XBRL Instance Document
- 101.SCH    XBRL Taxonomy Extension Schema Document
- 101.CAL    XBRL Taxonomy Extension Calculation Linkbase Document
- 101.LAB    XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE    XBRL Taxonomy Extension Presentation Linkbase Document
- 101.DEF    XBRL Taxonomy Extension Definition Linkbase Document

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\*Management contract or compensatory plan arrangement.

\*\*Stockholder approved compensatory plan pursuant to which DNB's Common Stock may be issued to employees of DNB