Community Bankers Trust Corp
Form 10-Q
August 08, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2014

or

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

For the transition period from _____ to _____

Commission File Number: 001-32590

COMMUNITY BANKERS TRUST CORPORATION

(Exact name of registrant as specified in its charter)

Virginia	**20-2652949**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
9954 Mayland Drive, Suite 2100 Richmond, Virginia	**23233**
(Address of principal executive offices)	**(Zip Code)**

(804) 934-9999

(Registrant s telephone number, including area code)

n/a

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

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

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

At June 30, 2014, there were 21,750,841 shares of the Company s common stock outstanding.

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COMMUNITY BANKERS TRUST CORPORATION

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PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

COMMUNITY BANKERS TRUST CORPORATION

CONSOLIDATED BALANCE SHEETS

AS OF JUNE 30, 2014 AND DECEMBER 31, 2013

(dollars in thousands)

	June 30, 2014 (Unaudited)	December 31, 2013 (Audited)
ASSETS		
Cash and due from banks	$ 13,865	$ 10,857
Interest bearing bank deposits	11,029	12,978
Total cash and cash equivalents	24,894	23,835
Securities available for sale, at fair value	266,772	265,777
Securities held to maturity, at cost (fair value of $27,782 and $30,305, respectively)	26,183	28,563
Equity securities, restricted, at cost	7,855	8,358
Total securities	300,810	302,698
Loans held for sale		100
Loans not covered by FDIC shared-loss agreements	632,343	596,173
Loans covered by FDIC shared-loss agreements	65,932	73,275
Total loans	698,275	669,448
Allowance for loan losses (non-covered loans of $10,254 and $10,444, respectively; covered loans of $386 and $484, respectively)	(10,640)	(10,928)
Net loans	687,635	658,520
FDIC indemnification asset	22,219	25,409
Bank premises and equipment, net	25,772	27,872
Bank premises and equipment held for sale	3,237	
Other real estate owned, covered by FDIC shared-loss agreements	2,967	2,692
Other real estate owned, non-covered	6,390	6,244
Bank owned life insurance	21,118	20,795
FDIC receivable under shared-loss agreements	594	368
Core deposit intangibles, net	5,667	6,621
Other assets	13,516	14,378

Total assets	$ 1,114,819	$ 1,089,532
LIABILITIES		
Deposits:		
Noninterest bearing	$ 78,744	$ 70,132
Interest bearing	836,072	822,209
Total deposits	914,816	892,341
Federal funds purchased and securities sold under agreements to repurchase	2,540	6,000
Federal Home Loan Bank advances	76,766	77,125
Long-term debt	10,680	
Trust preferred capital notes	4,124	4,124
Other liabilities	3,804	3,283
Total liabilities	1,012,730	982,873
SHAREHOLDERS EQUITY		
Preferred stock (5,000,000 shares authorized, $0.01 par value; 0 and 10,680 shares issued and outstanding, respectively)		10,680
Warrants on preferred stock		1,037
Common stock (200,000,000 shares authorized, $0.01 par value; 21,750,841 and 21,709,096 shares issued and outstanding, respectively)	218	217
Additional paid in capital	145,096	144,656
Retained deficit	(42,625)	(45,822)
Accumulated other comprehensive loss	(600)	(4,109)
Total shareholders equity	102,089	106,659
Total liabilities and shareholders equity	$ 1,114,819	$ 1,089,532

See accompanying notes to unaudited consolidated financial statements

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COMMUNITY BANKERS TRUST CORPORATION

UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2014 AND 2013

(dollars and shares in thousands, except per share data)

	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Interest and dividend income				
Interest and fees on non-covered loans	$ 7,291	$ 7,622	$ 14,342	$ 15,133
Interest and fees on FDIC covered loans	3,264	2,745	6,225	5,404
Interest on federal funds sold		1		3
Interest on deposits in other banks	22	14	35	22
Interest and dividends on securities				
Taxable	1,710	1,945	3,408	3,783
Nontaxable	168	164	324	312
Total interest and dividend income	12,455	12,491	24,334	24,657
Interest expense				
Interest on deposits	1,453	1,600	2,861	3,301
Interest on short-term borrowings	1	2	2	3
Interest on other borrowed funds	243	189	404	381
Total interest expense	1,697	1,791	3,267	3,685
Net interest income	10,758	10,700	21,067	20,972
Provision for loan losses				
Net interest income after provision for loan losses	10,758	10,700	21,067	20,972
Noninterest income				
Service charges on deposit accounts	561	701	1,050	1,364
Gain on securities transactions, net	24	130	379	408
Gain on sale of other loans, net	27		75	
Income on bank owned life insurance	193	199	385	348
Other	165	308	382	544
Total noninterest income	970	1,338	2,271	2,664
Noninterest expense				
Salaries and employee benefits	4,028	3,901	7,951	7,894
Occupancy expenses	687	717	1,335	1,380
Equipment expenses	260	247	479	514
Legal fees	29	38	57	51

Professional fees	135	139	242	189
FDIC assessment	194	223	401	390
Data processing fees	463	551	957	1,088
FDIC indemnification asset amortization	1,478	1,592	2,976	3,093
Amortization of intangibles	477	566	954	1,131
Other real estate expense	100	502	383	1,239
Other operating expenses	1,508	1,282	2,801	2,500
Total noninterest expense	9,359	9,758	18,536	19,469
Income before income taxes	2,369	2,280	4,802	4,167
Income tax expense	649	673	1,358	1,236
Net income	$ 1,720	$ 1,607	$ 3,444	$ 2,931
Dividends paid on preferred stock	182	221	247	442
Accretion of discount on preferred stock		59		117
Net income available to common shareholders	$ 1,538	$ 1,327	$ 3,197	$ 2,372
Net income per share basic	$ 0.07	$ 0.06	$ 0.15	$ 0.11
Net income per share diluted	$ 0.07	$ 0.06	$ 0.15	$ 0.11
Weighted average number of shares outstanding				
basic	21,742	21,696	21,736	21,689
diluted	21,939	21,835	21,972	21,858

See accompanying notes to unaudited consolidated financial statements

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COMMUNITY BANKERS TRUST CORPORATION

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2014 AND 2013

(dollars in thousands)

	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Net income	$ 1,720	$ 1,607	$ 3,444	$ 2,931
Other comprehensive income (loss):				
Change in unrealized (loss) gain in investment securities	1,950	(7,402)	5,696	(7,353)
Tax related to unrealized loss (gain) in investment securities	(663)	2,517	(1,937)	2,500
Reclassification adjustment for gain in securities sold	(24)	(130)	(379)	(408)
Tax related to realized gain in securities sold	8	44	129	139
Total other comprehensive income (loss)	1,271	(4,971)	3,509	(5,122)
Total comprehensive income (loss)	$ 2,991	$ (3,364)	$ 6,953	$ (2,191)

See accompanying notes to unaudited consolidated financial statements

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COMMUNITY BANKERS TRUST CORPORATION

UNAUDITED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

FOR THE SIX MONTHS ENDED JUNE 30, 2014 AND 2013

(dollars and shares in thousands)

	Preferred Stock	Warrants	Discount on Preferred Stock	Common Stock Shares	Common Stock Amount	Additional Paid in Capital	Retained Deficit	Accumulated Other Comprehensive Income	Total
Balance January 1, 2013	$ 17,680	$ 1,037	$ (234)	21,670	$ 217	$ 144,398	$ (50,609)	$ 2,828	$ 115,317
Amortization of preferred stock warrants			117				(117)		
Issuance of common stock				23		65			65
Dividends paid on preferred stock							(442)		(442)
Issuance of stock options						69			69
Net income							2,931		2,931
Other comprehensive loss								(5,122)	(5,122)
Balance June 30, 2013	$ 17,680	$ 1,037	$ (117)	21,693	$ 217	$ 144,532	$ (48,237)	$ (2,294)	$ 112,818
Balance January 1, 2014	$ 10,680	$ 1,037	$	21,709	$ 217	$ 144,656	$ (45,822)	$ (4,109)	$ 106,659
Issuance of common stock				42	1	90			91
Dividends paid on preferred stock							(247)		(247)
Issuance of stock options						93			93
Redemption of preferred stock	(10,680)								(10,680)
Redemption of warrants on preferred stock		(1,037)				257			(780)
Net income							3,444		3,444

Other comprehensive income							3,509	3,509
Balance June 30, 2014	$	$	$ 21,751	$ 218	$ 145,096	$ (42,625)	$ (600)	$ 102,089

See accompanying notes to unaudited consolidated financial statements

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COMMUNITY BANKERS TRUST CORPORATION

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED JUNE 30, 2014 AND 2013

(dollars in thousands)

	June 30, 2014	June 30, 2013
Operating activities:		
Net income	$ 3,444	$ 2,931
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and intangibles amortization	1,728	1,980
Issuance of common stock and stock options	184	134
Amortization of purchased loan premium	727	598
Deferred tax expense		1,236
Amortization of security premiums and accretion of discounts, net	1,840	1,826
Net gain on sale of securities	(379)	(408)
Net loss on sale and valuation of other real estate owned	314	1,048
Net gain on sale of loans	(75)	
Changes in assets and liabilities:		
Decrease in loans held for sale	100	713
Decrease in other assets	1,695	5,870
Increase (decrease) in accrued expenses and other liabilities	521	(51)
Net cash provided by operating activities	10,099	15,877
Investing activities:		
Proceeds from available for sale securities	68,160	115,760
Proceeds from held to maturity securities	3,602	6,390
Proceeds from equity securities	586	254
Purchase of available for sale securities	(66,522)	(93,840)
Purchase of equity securities	(82)	(85)
Proceeds from sale of other real estate	1,379	4,545
Improvements of other real estate, net of insurance proceeds	(178)	(186)
Net increase in loans	(37,283)	(16,263)
Principal recoveries of loans previously charged off	310	813
Purchase of premises and equipment, net	(1,915)	(536)
Purchase of bank owned life insurance investment		(5,000)
Proceeds from sale of loans	5,274	
Net cash (used in) provided by investing activities	(26,669)	11,852
Financing activities:		

Net increase (decrease) in noninterest bearing and interest bearing demand deposits	22,475	(21,410)
Net decrease in federal funds purchased	(3,460)	(4,412)
Net decrease in Federal Home Loan Bank borrowings	(359)	(349)
Cash dividends paid	(247)	(442)
Proceeds from long-term debt	10,680	
Redemption of preferred stock and related warrants	(11,460)	
Net cash provided by (used in) financing activities	17,629	(26,613)
Net increase in cash and cash equivalents	1,059	1,116
Cash and cash equivalents:		
Beginning of the period	$ 23,835	$ 24,137
End of the period	$ 24,894	$ 25,253

	June 30, 2014	June 30, 2013
Supplemental disclosures of cash flow information:		
Interest paid	$ 3,141	$ 3,818
Income taxes paid	1,364	
Transfers to other real estate owned	1,932	1,241
Transfer of building premises and equipment to held for sale	3,237	
Transfer of portfolio loans to held for sale		5,100

See accompanying notes to unaudited consolidated financial statements

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COMMUNITY BANKERS TRUST CORPORATION

Notes to Unaudited Consolidated Financial Statements

1. NATURE OF BANKING ACITIVIES AND SIGNIFICANT ACCOUNTING POLICIES

Organization

Community Bankers Trust Corporation (the Company) is a bank holding company that was originally incorporated in 2005. On January 1, 2014, the Company completed a reincorporation from Delaware, its original state of incorporation, to Virginia. The form of the reincorporation was the merger of the then existing Delaware corporation into a newly created Virginia corporation. The Company retained the same name and conducts business in the same manner as before the reincorporation.

The Company is headquartered in Richmond, Virginia and is the holding company for Essex Bank (the Bank), a Virginia state bank with 21 full-service offices, 14 of which are in Virginia and seven of which are in Maryland. The Bank also operates two loan production offices in Virginia. The Company relocated its corporate headquarters on March 31, 2014. The Bank opened a new branch office in Annapolis, Maryland on March 25, 2014 and a branch office at its new headquarters in Richmond, Virginia on April 7, 2014.

The Bank was established in 1926. The Bank engages in a general commercial banking business and provides a wide range of financial services primarily to individuals and small businesses, including individual and commercial demand and time deposit accounts, commercial and industrial loans, consumer and small business loans, real estate and mortgage loans, investment services, on-line and mobile banking products, and safe deposit box facilities.

Financial Statements

The consolidated statements presented include accounts of the Company and the Bank, its wholly-owned subsidiary. All material intercompany balances and transactions have been eliminated. The statements should be read in conjunction with the Company s consolidated financial statements and the accompanying notes to consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2013. The accounting and reporting policies of the Company conform to U.S. generally accepted accounting principles (GAAP) and to the general practices within the banking industry. The interim financial statements have not been audited; however, in the opinion of management, all adjustments, consisting of normal accruals, were made that are necessary to present fairly the balance sheet of the Company as of June 30, 2014, statements of shareholders equity and cash flows for the six months ended June 30, 2014, and statements of income statement and comprehensive income for the three and six months ended June 30, 2014. Results for the six month period ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014.

The financial information contained within the statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained when either earning income, recognizing an expense, recovering an asset or relieving a liability. The Company uses historical loss factors as one factor in determining the inherent loss that may be present in its loan portfolio. Actual losses could differ significantly from the historical factors that the Company uses. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of the Company s transactions would be the same, the timing of events that would impact its transactions could change.

Certain reclassifications have been made to prior period balances to conform to the current period presentation.

In preparing these financial statements, the Company has evaluated subsequent events and transactions for potential recognition or disclosure through the date the financial statements were issued.

Recent Accounting Pronouncements

In January 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-04, *Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40) - Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.* Although current guidance indicates that a creditor should reclassify a collateralized mortgage loan as other real estate owned when it determines that there has been *in substance a repossession or foreclosure* by the creditor, that is, the creditor receives *physical possession* of the debtor s assets *regardless of whether formal foreclosure proceedings take place,* the terms *in substance a repossession or foreclosure* and *physical possession* are not defined in the accounting literature. This has resulted in diversity about when a creditor should derecognize the loan receivable and recognize the real estate property. The objective of the amendments in this update is to reduce diversity by clarifying when an in substance repossession or foreclosure occurs. The amendments state that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential

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COMMUNITY BANKERS TRUST CORPORATION

Notes to Unaudited Consolidated Financial Statements

real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments are effective for public business entities for annual periods and interim periods within those annual periods beginning after December 15, 2014. Early adoption is permitted. The Company currently records foreclosures in accordance with this guidance; therefore, no changes are necessary for adoption.

Also in January 2014, the FASB issued ASU No. 2014-01, *Investments - Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects (a consensus of the FASB Emerging Issues Task Force).* The amendments in this ASU apply to all reporting entities that invest in qualified affordable housing projects through limited liability entities that are flow through entities for tax purposes. Currently, an investor that invests in a qualified affordable housing project may elect to account for that investment using the effective yield method. Those not electing the effective yield method would account for the investment using the equity method or cost method. The Task Force received stakeholder feedback indicating that certain of the required conditions for the effective yield method are overly restrictive and thus prevent many investments in qualified affordable housing projects from qualifying for the use of this method. Those stakeholders stated that presenting the investment performance net of taxes as a component of income tax expense (benefit) as prescribed by the effective yield method more fairly represents the economics and provides users with a better understanding of the returns from such investments than the equity or cost methods.

The amendments in this ASU eliminate the effective yield election and permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). Those not electing the proportional amortization method would account for the investment using the equity method or cost method. The decision to apply the proportional amortization method of accounting is an accounting policy decision that should be applied consistently to all qualifying affordable housing project investments rather than a decision to be applied to individual investments. A reporting entity should disclose information that enables users of its financial statements to understand the nature of its investments in qualified affordable housing projects, and the effect of the measurement of its investments in qualified affordable housing projects and the related tax credits on its financial position and results of operations. The amendments in this ASU should be applied retrospectively to all periods presented. The amendments in this ASU are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

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COMMUNITY BANKERS TRUST CORPORATION

Notes to Unaudited Consolidated Financial Statements

2. SECURITIES

Amortized costs and fair values of securities available for sale and held to maturity at June 30, 2014 and December 31, 2013 were as follows (dollars in thousands):

	June 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale				
U.S. Treasury issue and other U.S. Gov t agencies	$ 87,032	$ 101	$ (1,223)	$ 85,910
State, county and municipal	136,708	2,792	(2,215)	137,285
Corporate and other bonds	12,104	31	(43)	12,092
Mortgage backed U.S. Gov t agencies	2,598	25	(104)	2,519
Mortgage backed U.S. Gov t sponsored agencies	29,004	61	(99)	28,966
Total Securities Available for Sale	$ 267,446	$ 3,010	$ (3,684)	$ 266,772
Securities Held to Maturity				
State, county and municipal	$ 10,364	$ 714	$	$ 11,078
Mortgage backed U.S. Gov t agencies	5,504	324		5,828
Mortgage backed U.S. Gov t sponsored agencies	10,315	561		10,876
Total Securities Held to Maturity	$ 26,183	$ 1,599	$	$ 27,782

	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale				
U.S. Treasury issue and other U.S. Gov t agencies	$ 99,789	$ 165	$ (967)	$ 98,987
U.S. Gov t sponsored agencies	487		(1)	486
State, county and municipal	138,884	1,297	(6,085)	134,096
Corporate and other bonds	6,369	27	(47)	6,349
Mortgage backed U.S. Gov t agencies	3,608	29	(198)	3,439
Mortgage backed U.S. Gov t sponsored agencies	22,631	69	(280)	22,420
Total Securities Available for Sale	$ 271,768	$ 1,587	$ (7,578)	$ 265,777

Securities Held to Maturity				
State, county and municipal	$ 9,385	$ 718	$	$ 10,103
Mortgage backed U.S. Gov t agencies	6,604	398		7,002
Mortgage backed U.S. Gov t sponsored agencies	12,574	626		13,200
Total Securities Held to Maturity	$ 28,563	$ 1,742	$	$ 30,305

The amortized cost and fair value of securities at June 30, 2014 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations without any penalties (dollars in thousands):

	Held to Maturity		Available for Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 1,722	$ 1,739	$ 4,446	$ 4,426
Due after one year through five years	22,130	23,581	49,348	49,732
Due after five years through ten years	1,030	1,161	144,356	144,623
Due after ten years	1,301	1,301	69,296	67,991
Total securities	$ 26,183	$ 27,782	$ 267,446	$ 266,772

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Notes to Unaudited Consolidated Financial Statements

Proceeds from sales of securities available for sale were $22.9 million and $29.4 million during the three months ended June 30, 2014 and 2013, respectively, and $44.6 million and $54.6 million during the six months ended June 30, 2014 and 2013, respectively. Gains and losses on the sale of securities are determined using the specific identification method. Gross realized gains and losses on sales of securities available for sale during the periods were as follows (dollars in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Gross realized gains	$ 90	$ 145	$ 496	$ 470
Gross realized losses	(66)	(15)	(117)	(62)
Net securities gains	$ 24	$ 130	$ 379	$ 408

In estimating other than temporary impairment (OTTI) losses, management considers the length of time and the extent to which the fair value has been less than cost, the financial condition and short-term prospects for the issuer, and the intent and ability of management to hold its investment for a period of time to allow a recovery in fair value. There were no investments held that had OTTI losses for the three and six months ended June 30, 2014 and 2013.

The fair value and gross unrealized losses for securities available for sale, segregated by the length of time that individual securities have been in a continuous gross unrealized loss position, at June 30, 2014 and December 31, 2013 were as follows (dollars in thousands):

	June 30, 2014					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury issue and other U.S. Gov t agencies	$ 35,124	$ (565)	$ 38,551	$ (658)	$ 73,675	$ (1,223)
State, county and municipal	3,488	(24)	61,989	(2,191)	65,477	(2,215)
Corporate and other bonds	4,413	(43)			4,413	(43)
Mortgage backed U.S. Gov t agencies			1,893	(104)	1,893	(104)
Mortgage backed U.S. Gov t sponsored agencies	12,337	(76)	3,824	(23)	16,161	(99)
Total	$ 55,362	$ (708)	$ 106,257	$ (2,976)	$ 161,619	$ (3,684)

	December 31, 2013					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury issue and other U.S. Gov t agencies	$ 35,873	$ (531)	$ 37,638	$ (436)	$ 73,511	$ (967)
U.S. Gov t sponsored agencies	486	(1)			486	(1)
State, county and municipal	92,010	(5,343)	6,445	(742)	98,455	(6,085)
Corporate and other bonds	3,332	(42)	991	(5)	4,323	(47)
Mortgage backed U.S. Gov t agencies	2,767	(198)			2,767	(198)
Mortgage backed U.S. Gov t sponsored agencies	14,572	(258)	1,557	(22)	16,129	(280)
Total	$ 149,040	$ (6,373)	$ 46,631	$ (1,205)	$ 195,671	$ (7,578)

The unrealized losses (impairments) in the investment portfolio at June 30, 2014 and December 31, 2013 are generally a result of market fluctuations that occur daily. The unrealized losses are from 194 securities at June 30, 2014. Of those, 188 are investment grade, have U.S. government agency guarantees, or are backed by the full faith and credit of local municipalities throughout the United States. Six investment grade corporate obligations comprise the remaining securities with unrealized losses at June 30, 2014. The Company considers the reason for impairment, length of impairment and ability to hold until the full value is recovered in determining if the impairment is temporary in nature. Based on this analysis, the Company has determined these impairments to be temporary in nature. The Company does not intend to sell and it is more likely than not that the Company will not be required to sell these securities until they recover in value.

Market prices are affected by conditions beyond the control of the Company. Investment decisions are made by the management group of the Company and reflect the overall liquidity and strategic asset/liability objectives of the Company. Management analyzes the securities portfolio frequently and manages the portfolio to provide an overall positive impact to the Company s income statement and balance sheet.

Securities with amortized costs of $60.9 million and $109.1 million at June 30, 2014 and December 31, 2013, respectively, were pledged to secure public deposits and for other purposes required or permitted by law. At each of June 30, 2014 and December 31, 2013, there were no securities purchased from a single issuer, other than U.S. Treasury issue and other U.S. Government agencies that comprised more than 10% of the consolidated shareholders equity.

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3. LOANS NOT COVERED BY FDIC SHARED-LOSS AGREEMENT (NON-COVERED LOANS) AND RELATED ALLOWANCE FOR LOAN LOSSES

The Company s non-covered loans at June 30, 2014 and December 31, 2013 were comprised of the following (dollars in thousands):

	June 30, 2014		December 31, 2013	
	Amount	% of Non-Covered Loans	Amount	% of Non-Covered Loans
Mortgage loans on real estate:				
Residential 1-4 family	$ 156,173	24.69%	$ 144,382	24.21%
Commercial	275,286	43.52	247,284	41.47
Construction and land development	59,385	9.39	55,278	9.27
Second mortgages	6,459	1.02	6,854	1.15
Multifamily	33,898	5.36	35,774	6.00
Agriculture	8,127	1.28	9,565	1.60
Total real estate loans	539,328	85.26	499,137	83.70
Commercial loans	86,446	13.67	90,142	15.12
Consumer installment loans	5,379	0.85	5,623	0.94
All other loans	1,390	0.22	1,435	0.24
Gross loans	632,543	100.00%	596,337	100.00%
Less unearned income on loans	(200)		(164)	
Non-covered loans, net of unearned income	$ 632,343		$ 596,173	

The Company held $26.7 million and $38.5 million in balances of loans guaranteed by the United States Department of Agriculture (USDA), which are included in various categories in the table above, at June 30, 2014 and December 31, 2013, respectively. As these loans are 100% guaranteed by the USDA, no loan loss provision is required. These loan balances included an unamortized purchase premium of $1.6 million and $2.5 million at June 30, 2014 and December 31, 2013, respectively. Unamortized purchase premium is recognized as an adjustment of the related loan yield on a straight line basis, which is substantially equivalent to the results obtained using the effective interest method.

At June 30, 2014 and December 31, 2013, the Company s allowance for credit losses was comprised of the following: (i) specific valuation allowances calculated in accordance with FASB ASC 310, *Receivables,* (ii) general valuation allowances calculated in accordance with FASB ASC 450, *Contingencies*, based on economic conditions and other qualitative risk factors, and (iii) historical valuation allowances calculated using historical loan loss experience.

Management identified loans subject to impairment in accordance with ASC 310.

The Purchase and Assumption Agreement into which the Company and the Federal Deposit Insurance Corporation (FDIC) entered in January 2009 that provided for the Company s assumption of all of the deposits and certain other liabilities and acquisition of substantially all assets of Suburban Federal Savings Bank (SFSB) included two shared-loss agreements with respect to certain covered loans and foreclosed real estate assets. See Notes 4 and 5 for more information on the Purchase and Assumption Agreement and the shared-loss agreements. The shared-loss agreement for loans other than those secured by single family, residential 1-4 family mortgages expired March 31, 2014. These loans, which had an outstanding principal balance of $10.0 million and a carrying value of $5.5 million at March 31, 2014, are being accounted for in accordance with FASB ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality,* commonly referred to as purchased credit impaired loans, and were classified as non-covered loans effective April 1, 2014 (the PCI loans).

The PCI loans were not classified as nonperforming assets as of June 30, 2014, as the loans are accounted for on a pooled basis, and interest income, through accretion of the difference between the carrying amount of the loans and the expected cash flows, is being recognized on all PCI loans.

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The following table reflects the outstanding principal balance and carrying amounts of the PCI loans as of June 30, 2014 (dollars in thousands):

	June 30, 2014	
	Unpaid balance	Carrying Value
Mortgage loans on real estate:		
Residential 1-4 family	$ 2,218	$ 1,019
Commercial	3,290	1,244
Construction and land development	4,085	2,896
Second mortgages	37	19
Multifamily		
Agriculture		
Total real estate loans	9,630	5,178
Total PCI loans	$ 9,630	$ 5,178

The allowance for loan losses related to PCI loans was $98,000 as of March 31, 2014 and was transferred from the allowance for loan losses on covered loans effective April 1, 2014. This allowance was related to commercial real estate loans. There was no other activity in the allowance for loan losses related to PCI loans for either of the three or the six month periods ended June 30, 2014.

The change in the accretable yield balance for the PCI loans for the three months ended June 30, 2014 (dollars in thousands):

Balance transferred from covered loans, April 1, 2014	$ 4,773
Accretion	(187)
Reclassification from nonaccretable yield	808
Balance, June 30, 2014	$ 5,394

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The following table summarizes information related to impaired loans as of June 30, 2014 (dollars in thousands):

	Recorded Investment [1]	Unpaid Principal Balance [2]	Related Allowance
With an allowance recorded:			
Mortgage loans on real estate:			
Residential 1-4 family	$ 3,493	$ 3,620	$ 911
Commercial	542	714	101
Construction and land development	4,168	5,320	512
Second mortgages	223	226	41
Multifamily			
Agriculture			
Total real estate loans	8,426	9,880	1,565
Commercial loans	36	683	7
Consumer installment loans	91	93	17
All other loans			
Subtotal impaired loans with a valuation allowance	8,553	10,656	1,589
With no related allowance recorded:			
Mortgage loans on real estate:			
Residential 1-4 family	1,447	1,513	
Commercial	455	562	
Construction and land development	1,169	3,022	
Second mortgages			
Multifamily			
Agriculture			
Total real estate loans	3,071	5,097	
Commercial loans			
Consumer installment loans	5	6	
All other loans			
Subtotal impaired loans without a valuation allowance	3,076	5,103	

Total:			
Mortgage loans on real estate:			
Residential 1-4 family	4,940	5,133	911
Commercial	997	1,276	101
Construction and land development	5,337	8,342	512
Second mortgages	223	226	41
Multifamily			
Agriculture			
Total real estate loans	11,497	14,977	1,565
Commercial loans	36	683	7
Consumer installment loans	96	99	17
All other loans			
Total impaired loans	$ 11,629	$ 15,759	$ 1,589

(1) The amount of the investment in a loan, which is not net of a valuation allowance, but which does reflect any direct write-down of the investment

(2) The contractual amount due, which reflects paydowns applied in accordance with loan documents, but which does not reflect any direct write-downs

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The following table summarizes information related to impaired loans as of December 31, 2013 (dollars in thousands):

	Recorded Investment [1]	Unpaid Principal Balance [2]	Related Allowance
With an allowance recorded:			
Mortgage loans on real estate:			
Residential 1-4 family	$ 3,485	$ 3,739	$ 881
Commercial	920	1,091	150
Construction and land development	4,148	5,298	508
Second mortgages	225	226	40
Multifamily			
Agriculture			
Total real estate loans	8,778	10,354	1,579
Commercial loans	127	794	16
Consumer installment loans	49	51	9
All other loans			
Subtotal impaired loans with a valuation allowance	8,954	11,199	1,604
With no related allowance recorded:			
Mortgage loans on real estate:			
Residential 1-4 family	1,189	1,228	
Commercial	1,714	1,969	
Construction and land development	1,734	4,335	
Second mortgages			
Multifamily			
Agriculture	204	222	
Total real estate loans	4,841	7,754	
Commercial loans			
Consumer installment loans	6	6	
All other loans			
Subtotal impaired loans without a valuation allowance	4,847	7,760	

Total:			
Mortgage loans on real estate:			
Residential 1-4 family	4,674	4,967	881
Commercial	2,634	3,060	150
Construction and land development	5,882	9,633	508
Second mortgages	225	226	40
Multifamily			
Agriculture	204	222	
Total real estate loans	13,619	18,108	1,579
Commercial loans	127	794	16
Consumer installment loans	55	57	9
All other loans			
Total impaired loans	$ 13,801	$ 18,959	$ 1,604

(1) The amount of the investment in a loan, which is not net of a valuation allowance, but which does reflect any direct write-down of the investment

(2) The contractual amount due, which reflects paydowns applied in accordance with loan documents, but which does not reflect any direct write-downs

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The following table summarizes average recorded investment of impaired loans for the three and six months ended June 30, 2014 and 2013 (dollars in thousands):

	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Mortgage loans on real estate:				
Residential 1-4 family	$ 4,813	$ 6,327	$ 4,807	$ 6,092
Commercial	2,228	3,270	1,815	4,252
Construction and land development	5,622	8,801	5,609	8,728
Second mortgages	224	165	224	166
Multifamily				
Agriculture		229	102	237
Total real estate loans	12,887	18,792	12,557	19,475
Commercial loans	46	199	82	312
Consumer installment loans	97	77	76	74
All other loans				
Total impaired loans	$ 13,030	$ 19,068	$ 12,715	$ 19,861

The majority of impaired loans are also nonaccruing for which no interest income was recognized during each of the three and six months ended June 30, 2014 and 2013. No significant amounts of interest income were recognized on accruing impaired loans for each of the three and six months ended June 30, 2014 and 2013.

Interest income on nonaccrual loans, if recognized, is recorded using the cash basis method of accounting. Cash basis income of $158,000 and $297,000 was recognized during the three and six months ended June 30, 2014, respectively. There were no significant amounts recognized during either of the three or six months ended June 30, 2013. For the three months ended June 30, 2014 and 2013, estimated interest income of $230,000 and $298,000, respectively, would have been recorded if all such loans had been accruing interest according to their original contractual terms. For the six months ended June 30, 2014 and 2013, estimated interest income of $454,000 and $590,000, respectively, would have been recorded if all such loans had been accruing interest according to their original contractual terms.

The following table presents non-covered nonaccrual loans, excluding PCI loans, by loan category as of June 30, 2014 and December 31, 2013 (dollars in thousands):

	June 30, 2014	December 31, 2013
Mortgage loans on real estate:		
Residential 1-4 family	$ 4,617	$ 4,229

Commercial		874		1,382
Construction and land development		5,337		5,882
Second mortgages		223		225
Multifamily				
Agriculture				205
Total real estate loans		11,051		11,923
Commercial loans		36		127
Consumer installment loans		96		55
All other loans				
Total loans	$	11,183	$	12,105

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Troubled debt restructures still accruing interest are loans that management expects to ultimately collect all principal and interest due, but not under the terms of the original contract. A reconciliation of impaired loans to nonaccrual loans at June 30, 2014 and December 31, 2013, is set forth in the table below (dollars in thousands):

	June 30, 2014	December 31, 2013
Nonaccruals	$ 11,183	$ 12,105
Trouble debt restructure and still accruing	446	1,696
Total impaired	$ 11,629	$ 13,801

The following tables present an age analysis of past due status of non-covered loans, excluding PCI loans, by category as of June 30, 2014 and December 31, 2013 (dollars in thousands):

	June 30, 2014					
	30-89 Days Past Due	90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment 90 Days Past Due and Accruing
Mortgage loans on real estate:						
Residential 1-4 family	$ 957	$ 4,617	$ 5,574	$ 149,580	$ 155,154	$
Commercial	328	874	1,202	272,840	274,042	
Construction and land development	28	5,337	5,365	51,124	56,489	
Second mortgages		223	223	6,217	6,440	
Multifamily				33,898	33,898	
Agriculture				8,127	8,127	
Total real estate loans	1,313	11,051	12,364	521,786	534,150	
Commercial loans	191	36	227	86,219	86,446	
Consumer installment loans	11	96	107	5,272	5,379	
All other loans				1,390	1,390	
Total loans	$ 1,515	$ 11,183	$ 12,698	$ 614,667	$ 627,365	$

	December 31, 2013					
	30-89 Days Past Due	90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment 90 Days Past Due and Accruing
Mortgage loans on real estate:						
Residential 1-4 family	$ 1,455	$ 4,229	$ 5,684	$ 138,698	$ 144,382	$
Commercial		1,382	1,382	245,902	247,284	
Construction and land development	242	5,882	6,124	49,154	55,278	
Second mortgages		225	225	6,629	6,854	
Multifamily				35,774	35,774	
Agriculture		205	205	9,360	9,565	
Total real estate loans	1,697	11,923	13,620	485,517	499,137	
Commercial loans	115	127	242	89,900	90,142	
Consumer installment loans	58	55	113	5,510	5,623	
All other loans				1,435	1,435	
Total loans	$ 1,870	$ 12,105	$ 13,975	$ 582,362	$ 596,337	$

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Activity in the allowance for loan losses on non-covered loans, excluding PCI loans, by segment for the periods presented is presented in the following tables (dollars in thousands):

	Three Months Ended June 30, 2014				
	Beginning of Period	Provision Allocation	Charge-offs	Recoveries	End of Period
Mortgage loans on real estate:					
Residential 1-4 family	$ 3,707	$ (77)	$	$ 40	$ 3,670
Commercial	2,964	355	(412)	12	2,919
Construction and land development	1,894	(270)			1,624
Second mortgages	114	(17)		1	98
Multifamily	208	(32)			176
Agriculture	57	7			64
Total real estate loans	8,944	(34)	(412)	53	8,551
Commercial loans	1,332	31		115	1,478
Consumer installment loans	110	2	(34)	24	102
All other loans	24	1			25
Total loans	$ 10,410	$	$ (446)	$ 192	$ 10,156

	Three Months Ended June 30, 2013				
	Beginning of Period	Provision Allocation	Charge-offs	Recoveries	End of Period
Mortgage loans on real estate:					
Residential 1-4 family	$ 4,008	$ 52	$ (127)	$ 5	$ 3,938
Commercial	2,414	1,002	(913)	5	2,508
Construction and land development	3,357	(862)	(157)	527	2,865
Second mortgages	105	(34)		1	72
Multifamily	316	(170)			146
Agriculture	62		(6)		56
Total real estate loans	10,262	(12)	(1,203)	538	9,585
Commercial loans	1,816	(17)	(45)	18	1,772
Consumer installment loans	152	32	(54)	11	141
All other loans	28	(3)			25
Total loans	$ 12,258	$	$ (1,302)	$ 567	$ 11,523

	Six Months Ended June 30, 2014				
	Beginning of Period	Provision Allocation	Charge-offs	Recoveries	End of Period
Mortgage loans on real estate:					
Residential 1-4 family	$ 3,853	$ (120)	$ (110)	$ 47	$ 3,670
Commercial	2,333	917	(412)	81	2,919
Construction and land development	2,252	(629)		1	1,624
Second mortgages	101	(5)		2	98
Multifamily	151	25			176
Agriculture	81	(17)			64
Total real estate loans	8,771	171	(522)	131	8,551
Commercial loans	1,546	(187)		119	1,478
Consumer installment loans	101	17	(76)	60	102
All other loans	26	(1)			25
Total loans	$ 10,444	$	$ (598)	$ 310	$ 10,156

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Notes to Unaudited Consolidated Financial Statements

	Six Months Ended June 30, 2013				
	Beginning of Period	Provision Allocation	Charge-offs	Recoveries	End of Period
Mortgage loans on real estate:					
Residential 1-4 family	$ 3,985	$ 63	$ (161)	$ 51	$ 3,938
Commercial	2,482	1,508	(1,492)	10	2,508
Construction and land development	3,773	(1,427)	(157)	676	2,865
Second mortgages	142	(75)		5	72
Multifamily	303	(157)			146
Agriculture	61	1	(6)		56
Total real estate loans	10,746	(87)	(1,816)	742	9,585
Commercial loans	1,961	69	(297)	39	1,772
Consumer installment loans	195	11	(97)	32	141
All other loans	18	7			25
Total loans	$ 12,920	$	$ (2,210)	$ 813	$ 11,523

The following tables present information on the non-covered loans evaluated for impairment in the allowance for loan losses as of June 30, 2014 and December 31, 2013 (dollars in thousands):

	June 30, 2014 Allowance for Loan Losses			
	Individually Evaluated for Impairment [1]	Collectively Evaluated for Impairment	Related to PCI loans	Total
Mortgage loans on real estate:				
Residential 1-4 family	$ 961	$ 2,709	$	$ 3,670
Commercial	108	2,811	98	3,017
Construction and land development	540	1,084		1,624
Second mortgages	45	53		98
Multifamily		176		176
Agriculture		64		64
Total real estate loans	1,654	6,897	98	8,649
Commercial loans	417	1,061		1,478
Consumer installment loans	18	84		102
All other loans		25		25
Total loans	$ 2,089	$ 8,067	$ 98	$ 10,254

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	June 30, 2014 Recorded Investment in Loans			
	Individually Evaluated for Impairment [1]	Collectively Evaluated for Impairment	Related to PCI loans	Total
Mortgage loans on real estate:				
Residential 1-4 family	$ 7,262	$ 147,892	$ 1,019	$ 156,173
Commercial	9,400	264,642	1,244	275,286
Construction and land development	5,849	50,640	2,896	59,385
Second mortgages	252	6,188	19	6,459
Multifamily		33,898		33,898
Agriculture		8,127		8,127
Total real estate loans	22,763	511,387	5,178	539,328
Commercial loans	9,117	77,329		86,446
Consumer installment loans	102	5,277		5,379
All other loans		1,390		1,390
Total loans	$ 31,982	$ 595,383	$ 5,178	$ 632,543

	December 31, 2013					
	Allowance for Loan Losses			Recorded Investment in Loans		
	Individually Evaluated for Impairment [1]	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment [1]	Collectively Evaluated for Impairment	Total
Mortgage loans on real estate:						
Residential 1-4 family	$ 923	$ 2,930	$ 3,853	$ 6,708	$ 137,674	$ 144,382
Commercial	200	2,133	2,333	8,016	239,268	247,284
Construction and land development	651	1,601	2,252	8,619	46,659	55,278
Second mortgages	42	59	101	254	6,600	6,854
Multifamily		151	151		35,774	35,774
Agriculture		81	81	205	9,360	9,565
Total real estate loans	1,816	6,955	8,771	23,802	475,335	499,137
Commercial loans	18	1,528	1,546	192	89,950	90,142
Consumer installment loans	9	92	101	57	5,566	5,623
All other loans		26	26		1,435	1,435
Total loans	$ 1,843	$ 8,601	$ 10,444	$ 24,051	$ 572,286	$ 596,337

(1) The category Individually Evaluated for Impairment includes loans individually evaluated for impairment and determined not to be impaired. These loans totalled $20.4 million and $10.3 million at June 30, 2014 and December 31, 2013, respectively. The allowance for loans losses allocated to these loans was $500,000 and $239,000 at June 30, 2014 and December 31, 2013, respectively.

Non-covered loans are monitored for credit quality on a recurring basis. These credit quality indicators are defined as follows:

Pass - A pass loan is not adversely classified, as it does not display any of the characteristics for adverse classification. This category includes purchased loans that are 100% guaranteed by U.S. Government agencies of $26.7 million and $38.5 million at June 30, 2014 and December 31, 2013, respectively.

Special Mention - A special mention loan has potential weaknesses that deserve management s close attention. If left uncorrected, such potential weaknesses may result in deterioration of the repayment prospects or collateral position at some future date. Special mention loans are not adversely classified and do not warrant adverse classification.

Substandard - A substandard loan is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as substandard generally have a well defined weakness, or weaknesses, that jeopardize the liquidation of the debt. These loans are characterized by the distinct possibility of loss if the deficiencies are not corrected.

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Doubtful - A doubtful loan has all the weaknesses inherent in a loan classified as substandard with the added characteristics that the weaknesses make collection or liquidation in full highly questionable and improbable, on the basis of currently existing facts, conditions, and values.

The following tables present the composition of non-covered loans, excluding PCI loans, by credit quality indicator at June 30, 2014 and December 31, 2013 (dollars in thousands):

	June 30, 2014				
	Pass	Special Mention	Substandard	Doubtful	Total
Mortgage loans on real estate:					
Residential 1-4 family	$ 139,621	$ 9,551	$ 5,982	$	$ 155,154
Commercial	255,148	13,127	5,767		274,042
Construction and land development	50,421	219	5,849		56,489
Second mortgages	5,238	951	251		6,440
Multifamily	33,898				33,898
Agriculture	8,127				8,127
Total real estate loans	492,453	23,848	17,849		534,150
Commercial loans	74,994	2,335	9,117		86,446
Consumer installment loans	5,250	29	100		5,379
All other loans	1,390				1,390
Total loans	$ 574,087	$ 26,212	$ 27,066	$	$ 627,365

	December 31, 2013				
	Pass	Special Mention	Substandard	Doubtful	Total
Mortgage loans on real estate:					
Residential 1-4 family	$ 129,482	$ 8,193	$ 6,707	$	$ 144,382
Commercial	229,168	11,348	6,768		247,284
Construction and land development	44,482	2,178	8,618		55,278
Second mortgages	6,172	428	254		6,854
Multifamily	35,774				35,774
Agriculture	9,361		204		9,565
Total real estate loans	454,439	22,147	22,551		499,137
Commercial loans	87,208	2,742	192		90,142

Consumer installment loans	5,344	222	57	5,623
All other loans	1,435			1,435
Total loans	$ 548,426	$ 25,111	$ 22,800	$ 596,337

In accordance with FASB ASU 2011-02, *Receivables (Topic 310): A Creditor s Determination of Whether a Restructuring is a Troubled Debt Restructuring,* the Company assesses all loan modifications to determine whether they are considered troubled debt restructurings (TDRs) under the guidance.

During the three and six months ended June 30, 2014, there were no loans modified, that were considered to be TDRs. During each of the three and six months ended June 30, 2013, the Company modified one residential 1-4 family loan that was considered to be a TDR. The Company extended the terms and lowered the interest rate for this loan, which had a pre- and post-modification balance of $174,000.

A loan is considered to be in default if it is 90 days or more past due. There were no TDRs that had been restructured during the previous 12 months that resulted in default during the three and six months ended June 30, 2014 and 2013.

In the determination of the allowance for loan losses, management considers TDRs and subsequent defaults in these restructures by reviewing for impairment in accordance with FASB ASC 310-10-35, *Receivables, Subsequent Measurement*.

At June 30, 2014 the Company had 1-4 family mortgages in the amount of $144.8 million pledged as collateral to the Federal Home Loan Bank for a total borrowing capacity of $108.4 million.

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4. LOANS COVERED BY FDIC SHARED-LOSS AGREEMENTS (COVERED LOANS) AND RELATED ALLOWANCE FOR LOAN LOSSES

On January 30, 2009, the Company entered into a Purchase and Assumption Agreement with the FDIC to assume all of the deposits and certain other liabilities and acquire substantially all assets of SFSB. The Company is applying the provisions of FASB ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, to all loans acquired in the SFSB transaction (the covered loans). Of the total $198.3 million in loans acquired, $49.1 million met the criteria of FASB ASC 310-30. These loans, consisting mainly of construction loans, were deemed impaired at the acquisition date. The remaining $149.1 million of loans acquired, comprised mainly of residential 1-4 family, were analogized to meet the criteria of FASB ASC 310-30. Analysis of this portfolio revealed that SFSB utilized weak underwriting and documentation standards, which led the Company to believe that significant losses were probable given the economic environment at the time.

The shared-loss agreement related to loans other than those secured by single family, residential 1-4 family mortgages expired March 31, 2014. These loans, which had an outstanding principal balance of $10.0 million and a carrying value of $5.5 million at March 31, 2014, were transferred to non-covered loans effective April 1, 2014 (the PCI loans). See Note 3 for further details.

As of June 30, 2014 and December 31, 2013, the outstanding contractual balance of the covered loans was $101.2 million and $117.0 million, respectively. The carrying amount, by loan type, as of these dates is as follows (dollars in thousands):

	June 30, 2014		December 31, 2013	
	Amount	% of Covered Loans	Amount	% of Covered Loans
Mortgage loans on real estate:				
Residential 1-4 family	$ 62,044	94.10%	$ 64,610	88.18%
Commercial			1,389	1.90
Construction and land development			2,940	4.01
Second mortgages	3,617	5.49	3,898	5.32
Multifamily	271	0.41	266	0.36
Agriculture			172	0.23
Total real estate loans	65,932	100.00	73,275	100.00
Total covered loans	$ 65,932	100.00%	$ 73,275	100.00%

The allowance for loan losses related to the PCI loans of $98,000 was transferred to the non-covered allowance for loan losses effective April 1, 2014, and was related to commercial real estate loans. The remaining allowance for loan losses on covered loans of $386,000 at June 30, 2014, related to residential 1-4 family loans. There was no other

activity in the allowance for loan losses on covered loans for either the three or six months ended June 30, 2014. There was no activity in the allowance for loan losses on covered loans for either the three or six months ended June 30, 2013.

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The following table presents information on the covered loans collectively evaluated for impairment in the allowance for loan losses at June 30, 2014 and December 31, 2013 (dollars in thousands):

	June 30, 2014		December 31, 2013	
	Allowance for loan losses	Recorded investment in loans	Allowance for loan losses	Recorded investment in loans
Mortgage loans on real estate:				
Residential 1-4 family	$ 386	$ 62,044	$ 252	$ 64,610
Commercial			232	1,389
Construction and land development				2,940
Second mortgages		3,617		3,898
Multifamily		271		266
Agriculture				172
Total real estate loans	386	65,932	484	73,275
Total covered loans	$ 386	$ 65,932	$ 484	$ 73,275

The change in the accretable yield balance for the six months ended June 30, 2014 and the year ended December 31, 2013 is as follows (dollars in thousands):

Balance, January 1, 2013	$ 54,144
Accretion	(11,936)
Reclassification from nonaccretable yield	9,307
Balance, December 31, 2013	51,515
Accretion	(6,225)
Reclassification from nonaccretable yield	10,203
Transfer of PCI loans to non-covered loans	(4,773)
Balance, June 30, 2014	$ 50,720

The covered loans were not classified as nonperforming assets as of June 30, 2014, as the loans are accounted for on a pooled basis, and interest income, through accretion of the difference between the carrying amount of the loans and the expected cash flows, is being recognized on all covered loans.

5. FDIC AGREEMENTS AND FDIC INDEMNIFICATION ASSET

On January 30, 2009, the Company entered into a Purchase and Assumption Agreement with the FDIC to assume all of the deposits and certain other liabilities and acquire substantially all assets of SFSB. Under the shared-loss agreements that are part of that agreement, the FDIC will reimburse the Bank for 80% of losses arising from covered loans and foreclosed real estate assets, on the first $118 million in losses on such covered loans and foreclosed real estate assets, and for 95% of losses on covered loans and foreclosed real estate assets thereafter. Under the shared-loss agreements, a loss on a covered loan or foreclosed real estate is defined generally as a realized loss incurred through a permitted disposition, foreclosure, short-sale or restructuring of the covered loan or foreclosed real estate. The reimbursements for losses on single family, 1-4 family residential mortgage assets are to be made quarterly through March 2019, and the reimbursements for losses on other covered assets were made quarterly through March 2014. The shared-loss agreements provide for indemnification from the first dollar of losses without any threshold requirement. The reimbursable losses from the FDIC are based on the book value of the relevant loan as determined by the FDIC at the date of the transaction, January 30, 2009. New loans made after that date are not covered by the shared-loss agreements. The fair value of the shared-loss agreements is detailed below.

The Company is accounting for the shared-loss agreements as an indemnification asset pursuant to the guidance in FASB ASC 805, *Business Combinations*. The FDIC indemnification asset is required to be measured in the same manner as the asset or liability to which it relates. The FDIC indemnification asset is measured separately from the covered loans and other real estate owned assets (OREO) because it is not contractually embedded in the covered loan and OREO and is not transferable should the Company choose to dispose of them. Fair value was estimated using projected cash flows available for loss sharing based on the credit adjustments estimated for each loan pool and other real estate owned and the loss sharing percentages outlined in the shared-loss agreements with the FDIC. These cash flows were discounted to reflect the uncertainty of the timing and receipt of the loss sharing reimbursement from the FDIC.

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Because the acquired loans are subject to shared-loss agreements and a corresponding indemnification asset exists to represent the value of expected payments from the FDIC, increases and decreases in loan accretable yield due to changing loss expectations will also have an impact to the valuation of the FDIC indemnification asset. Improvement in loss expectations will typically increase loan accretable yield and decrease the value of the FDIC indemnification asset and, in some instances, result in an amortizable premium on the FDIC indemnification asset. Increases in loss expectations will typically be recognized as impairment in the current period through allowance for loan losses, resulting in additional noninterest income for the amount of the increase in the FDIC indemnification asset.

In addition to the premium amortization, the balance of the FDIC indemnification asset is affected by expected payments from the FDIC. Under the terms of the shared-loss agreements, the FDIC will reimburse the Company for loss events incurred related to the covered loan portfolio. These events include such things as future writedowns due to decreases in the fair market value of OREO, net loan charge-offs and recoveries, and net gains and losses on OREO sales.

As discussed above, the shared-loss agreement for assets other than single family, 1-4 residential mortgage assets expired March 2014. The FDIC indemnification asset related to those assets was zero March 31, 2014.

The following table presents the balances of the FDIC indemnification asset at June 30, 2014 and December 31, 2013 (dollars in thousands):

	Anticipated Expected Losses	Estimated Loss Sharing Value	Amortizable Premium (Discount) at Present Value	FDIC Indemnification Asset Total
January 1, 2013	$ 23,205	$ 18,564	$ 15273	$ 33,837
Increases:				
Writedown of OREO property to FMV	344	275		275
Decreases:				
Net amortization of premium			(6,449)	6,449)
Reclassifications to FDIC receivable:				
Net loan charge-offs and recoveries	(1,268)	(1,014)		(1,014)
OREO sales	(1,180)	(944)		(944)
Reimbursements requested from FDIC	(370)	(296)		(296)
Reforecasted Change in Anticipated Expected Losses	(7,217)	(5,774)	5,774	
December 31, 2013	$ 13,514	$ 10,811	$ 14,598	$ 25,409
Increases:				
Writedown of OREO property to FMV	34	27		27

Decreases:				
Net amortization of premium			(2,976)	(2,976)
Reclassifications to FDIC receivable:				
Net loan charge-offs and recoveries	(46)	(37)		(37)
OREO sales	(140)	(112)		(112)
Reimbursements requested from FDIC	(115)	(92)		(92)
Reforecasted Change in Anticipated Expected Losses	(6,185)	(4,949)	4,949	
June 30, 2014	$ 7,062	$ 5,648	$ 16,571	$ 22,219

6. DEPOSITS

The following table provides interest bearing deposit information, by type, as of June 30, 2014 and December 31, 2013 (dollars in thousands):

	June 30, 2014	December 31, 2013
NOW	$ 114,530	$ 102,111
MMDA	92,602	94,170
Savings	77,381	75,159
Time deposits less than $100,000	243,509	235,482
Time deposits $100,000 and over	308,050	315,287
Total interest bearing deposits	$ 836,072	$ 822,209

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7. LONG-TERM DEBT

On April 23, 2014, the Company repurchased the then outstanding 10,680 shares of Series A Preferred Stock (see Note 10). The Company funded the repurchase through an unsecured third-party term loan. The term loan, which has a maturity date of April 21, 2017, requires that the Company make quarterly payments of 7.5% of the initial outstanding principal, plus accrued interest, during a six-quarter period beginning with the quarter ending December 31, 2014, quarterly payments of 10% of the initial outstanding principal, plus accrued interest, during the subsequent four-quarter period and the remaining principal amount and accrued interest at maturity. The interest rate resets quarterly based on three-month LIBOR plus 3.50% per annum. As of June 30, 2014 the interest rate was 3.73%.

8. ACCUMULATED OTHER COMPREHENSIVE LOSS

The following tables present activity net of tax in accumulated other comprehensive loss (AOCL) for the three and six months ended June 30, 2014 and 2013 (dollars in thousands):

	Three months ended June 30, 2014		
	Unrealized Gain (Loss) on Securities	Defined Benefit Pension Plan	Total Other Comprehensive Loss
Beginning balance	$ (1,716)	$ (155)	$ (1,871)
Other comprehensive income before reclassifications	1,287		1,287
Amounts reclassified from AOCL	(16)		(16)
Net current period other comprehensive income	1,271		1,271
Ending balance	$ (445)	$ (155)	$ (600)

	Three months ended June 30, 2013		
	Unrealized Gain (Loss) on Securities	Defined Benefit Pension Plan	Total Other Comprehensive Loss
Beginning balance	$ 3,715	$ (1,038)	$ 2,677
	(4,885)		(4,885)

Other comprehensive loss before reclassifications			
Amounts reclassified from AOCL	(86)		(86)
Net current period other comprehensive loss	(4,971)		(4,971)
Ending balance	$ (1,256)	$ (1,038)	$ (2,294)

	Six months ended June 30, 2014		
	Unrealized Gain (Loss) on Securities	**Defined Benefit Pension Plan**	**Total Other Comprehensive Loss**
Beginning balance	$ (3,954)	$ (155)	$ (4,109)
Other comprehensive income before reclassifications	3,759		3,759
Amounts reclassified from AOCL	(250)		(250)
Net current period other comprehensive income	3,509		3,509
Ending balance	$ (445)	$ (155)	$ (600)

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	Six months ended June 30, 2013		
	Unrealized Gain (Loss) on Securities	Defined Benefit Pension Plan	Total Other Comprehensive Loss
Beginning balance	$ 3,866	$ (1,038)	$ 2,828
Other comprehensive loss before reclassifications	(4,853)		(4,853)
Amounts reclassified from AOCL	(269)		(269)
Net current period other comprehensive loss	(5,122)		(5,122)
Ending balance	$ (1,256)	$ (1,038)	$ (2,294)

The following tables present the effects of reclassifications out of accumulated other comprehensive loss on line items of consolidated income for the three and six months ended June 30, 2014 and 2013 (dollars in thousands):

Details about Accumulated Other Comprehensive Loss Components	Amount Reclassified from Accumulated Other Comprehensive Loss Three months ended June 30, 2014	June 30, 2013	Affected Line Item in the Unaudited Consolidated Statement of Income
Unrealized (gains) losses on securities available for sale	$ (24)	$ (130)	Gain on securities transactions, net
	8	44	Income tax expense
	$ (16)	$ (86)	Net of tax

Details about Accumulated Other Comprehensive Loss Components	Amount Reclassified from Accumulated Other Comprehensive Loss Six months ended June 30, 2014	June 30, 2013	Affected Line Item in the Unaudited Consolidated Statement of Income

Unrealized (gains) losses on securities available for sale	$ (379)	$ (408)	Gain on securities transactions, net
	129	139	Income tax expense
	$ (250)	$ (269)	Net of tax

9. FAIR VALUES OF ASSETS AND LIABILITIES

FASB ASC 820, *Fair Value Measurements and Disclosures,* defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820 requires that valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs and also establishes a fair value hierarchy that prioritizes the valuation inputs into three broad levels. The Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Valuation is determined using model-based techniques with significant assumptions not observable in the market. These unobservable assumptions reflect the Company s own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of third party pricing services, option pricing models, discounted cash flow models and similar techniques.

FASB ASC 825, *Financial Instruments*, allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis. The Company has not made any material FASB ASC 825 elections as of June 30, 2014.

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Notes to Unaudited Consolidated Financial Statements

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The Company utilizes fair value measurements to record adjustments to certain assets to determine fair value disclosures. Securities available for sale and loans held for sale are recorded at fair value on a recurring basis. The tables below present the recorded amount of assets and liabilities measured at fair value on a recurring basis (dollars in thousands):

	June 30, 2014			
	Total	Level 1	Level 2	Level 3
Investment securities available for sale				
U.S. Treasury issue and other U.S. Gov t agencies	$ 85,910	$ 81,228	$ 4,682	$
U.S. Gov t sponsored agencies				
State, county and municipal	137,285		137,285	
Corporate and other bonds	12,092	2,731	9,361	
Mortgage backed U.S. Gov t agencies	2,519		2,519	
Mortgage backed U.S. Gov t sponsored agencies	28,966	6,130	22,836	
Total investment securities available for sale	266,772	90,089	176,683	
Total assets at fair value	$ 266,772	$ 90,089	$ 176,683	$
Total liabilities at fair value	$	$	$	$

	December 31, 2013			
	Total	Level 1	Level 2	Level 3
Investment securities available for sale				
U.S. Treasury issue and other U.S. Gov t agencies	$ 98,987	$ 94,935	$ 4,052	$
U.S. Gov t sponsored agencies	486		486	
State, county and municipal	134,096	2,482	131,614	
Corporate and other bonds	6,349		6,349	
Mortgage backed U.S. Gov t agencies	3,439		3,439	
Mortgage backed U.S. Gov t sponsored agencies	22,420	2,531	19,889	
Total investment securities available for sale	265,777	99,948	165,829	
Loans held for sale	100		100	

Total assets at fair value	$ 265,877	$ 99,948	$ 165,929	$
Total liabilities at fair value	$	$	$	$

Investment securities available for sale

Investment securities available for sale are recorded at fair value each reporting period. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security s credit rating, prepayment assumptions and other factors such as credit loss assumptions.

The Company utilizes a third party vendor to provide fair value data for purposes of determining the fair value of its available for sale securities portfolio. The third party vendor uses a reputable pricing company for security market data. The third party vendor has controls and edits in place for month-to-month market checks and zero pricing, and a Statement on Standards for Attestation Engagements No. 16 report is obtained from the third party vendor on an annual basis. The Company makes no adjustments to the pricing service data received for its securities available for sale.

Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

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Loans held for sale

The carrying amounts of loans held for sale approximate fair value.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Company is also required to measure and recognize certain other financial assets at fair value on a nonrecurring basis on the consolidated balance sheet. The following table presents assets measured at fair value on a nonrecurring basis for the period ended June 30, 2014 and December 31, 2013 (dollars in thousands):

	June 30, 2014			
	Total	**Level 1**	**Level 2**	**Level 3**
Impaired loans, non-covered	$ 7,929	$	$ 778	$ 7,151
Other real estate owned (OREO), non-covered	6,390			6,390
Other real estate owned (OREO), covered	2,967			2,967
Total assets at fair value	$ 17,286	$	$ 778	$ 16,508
Total liabilities at fair value	$	$	$	$

	December 31, 2013			
	Total	**Level 1**	**Level 2**	**Level 3**
Impaired loans, non-covered	$ 10,334	$	$ 1,791	$ 8,543
Other real estate owned (OREO), non-covered	6,244			6,244
Other real estate owned (OREO), covered	2,692			2,692
Total assets at fair value	$ 19,270	$	$ 1,791	$ 17,479
Total liabilities at fair value	$	$	$	$

Impaired loans, non-covered

Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures the impairment in accordance with FASB ASC 310, *Receivables*. The fair value of impaired loans is estimated using one of several methods, including collateral value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceeds the recorded investments in such loans. At June 30, 2014 and December 31, 2013, a majority of total impaired

loans were evaluated based on the fair value of the collateral. The Company frequently obtains appraisals prepared by external professional appraisers for classified loans greater than $250,000 when the most recent appraisal is greater than 12 months old. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan within Level 2.

The Company may also identify collateral deterioration based on current market sales data, including price and absorption, as well as input from real estate sales professionals and developers, county or city tax assessments, market data and on-site inspections by Company personnel. Internally prepared estimates generally result from current market data and actual sales data related to the Company s collateral or where the collateral is located. When management determines that the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3. In instances where an appraisal received subsequent to an internally prepared estimate reflects a higher collateral value, management does not revise the carrying amount. Impaired loans can also be evaluated for impairment using the present value of expected future cash flows discounted at the loan s effective interest rate. The measurement of impaired loans using future cash flows discounted at the loan s effective interest rate rather than the market rate of interest rate is not a fair value measurement and is therefore excluded from fair value disclosure requirements. Reviews of classified loans are performed by management on a quarterly basis.

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Other real estate owned, covered and non-covered

Other real estate owned (OREO) assets are adjusted to fair value less estimated selling costs upon transfer of the related loans to OREO property. Subsequent to the transfer, valuations are periodically performed by management and the assets are carried at the lower of carrying value or fair value less estimated selling costs. Fair value is based upon independent market prices, appraised values of the collateral or management s estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset within Level 2. When an appraised value is not available or management determines that the fair value of the collateral is further impaired below the appraised value due to such things as absorption rates and market conditions, the Company records the foreclosed asset within Level 3 of the fair value hierarchy.

Fair Value of Financial Instruments

FASB ASC 825, *Financial Instruments*, requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring or nonrecurring basis. FASB ASC 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

The following reflects the fair value of financial instruments, whether or not recognized on the consolidated balance sheet, at fair value measures by level of valuation assumptions used for those assets. This table excludes financial instruments for which the carrying value approximates fair value (dollars in thousands):

	June 30, 2014				
		Estimated Fair			
	Carrying Value	Value	Level 1	Level 2	Level 3
Financial assets:					
Securities held to maturity	$ 26,183	$ 27,782	$	$ 27,782	$
Loans, non-covered	622,089	627,068		614,520	12,548
Loans, covered	65,546	73,865			73,865
FDIC indemnification asset	22,219	5,441			5,441
Financial liabilities:					
Interest bearing deposits	836,072	839,076		839,076	
Long-term borrowings	91,570	91,537		91,537	

	December 31, 2013				
		Estimated Fair			
	Carrying Value	Value	Level 1	Level 2	Level 3

Financial assets:				
Securities held to maturity	$ 28,563	$ 30,305	$	$ 30,305 $
Loans, non-covered	585,729	591,081		582,538 8,543
Loans, covered	72,791	88,693		88,693
FDIC indemnification asset	25,409	10,557		10,557
Financial liabilities:				
Interest bearing deposits	822,209	824,895		824,895
Long-term borrowings	81,249	81,014		81,014

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying balance sheets at amounts other than fair value as of June 30, 2014. The Company applied the provisions of FASB ASC 820 to the fair value measurements of financial instruments not recognized on the consolidated balance sheet at fair value. The provisions requiring the Company to maximize the use of observable inputs and to measure fair value using a notion of exit price were factored into the Company s selection of inputs into its established valuation techniques.

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Financial Assets

Cash and cash equivalents

The carrying amounts of cash and due from banks, interest bearing bank deposits, and federal funds sold approximate fair value.

Securities held for investment

For securities held for investment, fair values are based on quoted market prices or dealer quotes.

Restricted securities

The carrying value of restricted securities approximates their fair value based on the redemption provisions of the respective issuer.

Loans held for sale

The carrying amounts of loans held for sale approximate fair value.

Loans not covered by FDIC shared-loss agreement (non-covered loans)

The fair value of loans, excluding PCI loans, is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. The fair value of impaired loans is consistent with the methodology used for the FASB ASC 820 disclosure for assets recorded at fair value on a nonrecurring basis presented above. The fair value of non-covered loans that are PCI loans is estimated using the same methodology described below for covered loans.

Loans covered by FDIC shared-loss agreement (covered loans) and PCI loans

Fair values for covered loans and PCI loans are based on a discounted cash flow methodology that considers various factors including the type of loan and related collateral, classification status, term of loan and whether or not the loans are amortizing. Loans were pooled together according to similar characteristics and were treated in the aggregate when applying various valuation techniques. The discount rates used for loans are based on the rates used at acquisition (which were based on market rates for new originations of comparable loans) adjusted for any material changes in interest rates since acquisition. Increases in cash flow expectations since acquisition resulted in estimated fair value being higher than carrying value. The increase in cash flows is also reflected in a transfer from unaccretable yield to accretable yield as disclosed in Note 4.

FDIC indemnification asset

Loss sharing assets are measured separately from the related covered assets as they are not contractually embedded in the covered assets and are not transferable with the assets should the Company choose to dispose of them. Fair value is estimated using projected cash flows related to the obligations under the shared-loss agreements based on the expected reimbursements for losses and the applicable loss sharing percentages. These expected reimbursements do not include reimbursable amounts related to future covered expenditures. These cash flows were discounted to reflect the uncertainty of the timing and receipt of the loss sharing reimbursement from the FDIC. A reduction in loss expectations has resulted in the estimated fair value of the FDIC indemnification asset being lower than its carrying value. This creates a premium that is amortized over the life of the asset and is reflected in Note 5.

Accrued interest receivable

The carrying amounts of accrued interest receivable approximate fair value.

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Financial Liabilities

Noninterest bearing deposits

The carrying amount of noninterest bearing deposits approximates fair value.

Interest bearing deposits

The fair value of NOW accounts, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities.

Federal funds purchased and securities sold under agreements to repurchase

The carrying amount of federal funds purchased and securities sold under agreements to repurchase approximates fair value.

Long-term borrowings

The fair values of the Company s long-term borrowings, such as FHLB advances and long-term debt, are estimated using discounted cash flow analyses based on the Company s current incremental borrowing rates for similar types of borrowing arrangements.

Accrued interest payable

The carrying amounts of accrued interest payable approximate fair value.

Off-balance sheet financial instruments

The fair value of commitments to extend credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of stand-by letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. The Company s off-balance sheet commitments are funded at current market rates at the date they are drawn upon. It is management s opinion that the fair value of these commitments would approximate their carrying value, if drawn upon.

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Company s financial instruments will change when interest rate levels change, and that change may be either favorable or unfavorable. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate

obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company s overall interest rate risk.

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10. EARNINGS PER COMMON SHARE

Basic earnings per common share (EPS) is computed by dividing net income or loss available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted EPS is computed using the weighted average number of common shares outstanding during the period, including the effect of all potentially dilutive common shares outstanding attributable to stock instruments (dollars and shares in thousands, except per share data):

	Net Income Available to Common Shareholders (Numerator)	Weighted Average Common Shares (Denominator)	Per Common Share Amount
For the three months ended June 30, 2014			
Basic EPS	$ 1,538	21,742	$ 0.07
Effect of dilutive stock awards		197	
Diluted EPS	$ 1,538	21,939	$ 0.07
For the three months ended June 30, 2013			
Shares issued		21,685	
Unissued vested restricted stock		11	
Basic EPS	$ 1,327	21,696	$ 0.06
Effect of dilutive stock awards		139	
Diluted EPS	$ 1,327	21,835	$ 0.06

	Net Income Available to Common Shareholders	Weighted Average Common Shares (Denominator)	Per Common Share Amount

	(Numerator)			
For the six months ended June 30, 2014				
Basic EPS	$ 3,197	21,736	$	0.15
Effect of dilutive stock awards		236		
Diluted EPS	$ 3,197	21,972	$	0.15
For the six months ended June 30, 2013				
Shares issued		21,678		
Unissued vested restricted stock		11		
Basic EPS	$ 2,372	21,689	$	0.11
Effect of dilutive stock awards		169		
Diluted EPS	$ 2,372	21,858	$	0.11

Excluded from the computation of diluted earnings per common share were 36,000 common shares issuable under awards or options during the three and six months ended June 30, 2014, because their inclusion would be anti-dilutive. Anti-dilutive common shares issuable under awards, options or warrants of 846,000 were excluded for the three and six months ended June 30, 2013.

In December 2008, the Company issued 17,680 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A to the United States Department of Treasury in connection with the Company s participation in the Treasury s TARP Capital Purchase Program. Under the terms of the Series A Preferred Stock, prior to its redemption, as discussed below, the Company was required to pay cumulative dividends on a quarterly basis at a rate of 5% per year on such amount through the February 2014 payment. After the February 2014 payment, the dividend rate automatically increased to 9% per year. The Company could defer dividend payments, but the dividend was a cumulative dividend that accrued for payment in the future. Deferred dividends also accrued interest at the same rate as the dividend. The failure to pay dividends for six dividend periods triggered the right for the holder of the Series A Preferred Stock to appoint two directors to the Company s board.

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COMMUNITY BANKERS TRUST CORPORATION

Notes to Unaudited Consolidated Financial Statements

During 2013, the Company repurchased 7,000 shares of the original 17,680 shares of Series A Preferred Stock. The Company funded the repurchase through the earnings of its banking subsidiary.

On April 23, 2014, the Company repurchased the remaining 10,680 shares of Series A Preferred Stock. The Company funded the repurchase through a term loan with SunTrust Bank (See Note 7). The form of the repurchase was a redemption under the terms of the TARP preferred stock. The Company paid the Treasury $10.9 million, which represented 100% of the par value of the preferred stock repurchased plus accrued dividends with respect to such shares.

On June 4, 2014, the Company paid the Treasury $780,000 to repurchase the warrant that had been associated with the Series A Preferred Stock. The Company had originally issued the warrant, which permitted Treasury to purchase 780,000 shares of the Company s common stock at an exercise price of $3.40, in December 2008. There are no other investments from the Company s participation in TARP that remain outstanding.

11. DEFINED BENEFIT PLAN

On May 31, 2008, the Company adopted the Bank of Essex noncontributory defined benefit pension plan for all full-time pre-merger Bank employees over 21 years of age. Benefits are generally based upon years of service and the employees compensation. The Company funds pension costs in accordance with the funding provisions of the Employee Retirement Income Security Act. The Company has frozen the plan benefits for all participants effective December 31, 2010. The following table presents the components of net periodic benefit cost for the three and six months ended June 30, 2014 and 2013 (dollars in thousands):

	Three months ended		Six months ended	
(dollars in thousands)	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Interest cost	$ 56	$ 56	$ 111	$ 112
Expected return on plan assets	(99)	(101)	(198)	(202)
Amortization of prior service cost	1		2	
Recognized net actuarial loss	3	17	6	35
Net periodic benefit cost	$ (39)	$ (28)	$ (79)	$ (55)

As of June 30, 2014, there had been no employer contributions for the plan year. The Company is considering terminating the pension plan in the future. No determination has been made and the Company has not determined the financial impact of the termination of the plan.

12. BRANCH SALES

The Company is currently marketing for sale its office in Crofton, Maryland, which had been the former SFSB headquarters, and its office in Catonsville, Maryland. In accordance with FASB ASC 360, *Property, Plant and Equipment*, the net book value of the offices, excluding furniture and equipment, of $2.8 million and $464,000, respectively, were classified as held for sale at June 30, 2014, as it represents the lower of cost or fair market value. In connection with the potential sale, the Company intends to lease approximately 66% of the Crofton office, including the current branch location. Any resulting gain will be deferred over the life of the lease in accordance with FASB ASC 840-40, *Leases, Sale-Leaseback Transactions*.

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion and analysis of the financial condition at June 30, 2014 and results of operations of Community Bankers Trust Corporation (the Company) for the three and six months ended June 30, 2014 should be read in conjunction with the Company s consolidated financial statements and the accompanying notes to consolidated financial statements included in this report and in the Company s Annual Report on Form 10-K for the year ended December 31, 2013.

OVERVIEW

Community Bankers Trust Corporation (the Company) is headquartered in Richmond, Virginia and is the holding company for Essex Bank (the Bank), a Virginia state bank with 21 full-service offices, 14 of which are in Virginia and seven of which are in Maryland. The Bank also operates two loan production offices in Virginia. The Company relocated its corporate headquarters on March 31, 2014. The Bank opened a new branch office in Annapolis, Maryland on March 25, 2014 and a branch office at its new headquarters in Richmond, Virginia on April 7, 2014.

The Bank was established in 1926. The Bank engages in a general commercial banking business and provides a wide range of financial services primarily to individuals and small businesses, including individual and commercial demand and time deposit accounts, commercial and industrial loans, consumer and small business loans, real estate and mortgage loans, investment services, on-line and mobile banking products, and safe deposit box facilities.

The Company generates a significant amount of its income from the net interest income earned by the Bank. Net interest income is the difference between interest income and interest expense. Interest income depends on the amount of interest earning assets outstanding during the period and the interest rates earned thereon. The Company s cost of funds is a function of the average amount of interest bearing deposits and borrowed money outstanding during the period and the interest rates paid thereon. The quality of the assets further influences the amount of interest income lost on nonaccrual loans and the amount of additions to the allowance for loan losses. Additionally, the Bank earns noninterest income from service charges on deposit accounts and other fee or commission-based services and products. Other sources of noninterest income can include gains or losses on securities transactions, gains from loan sales, transactions involving bank-owned property, and income from Bank Owned Life Insurance (BOLI) policies. The Company s income is offset by noninterest expense, which consists of salaries and benefits, occupancy and equipment costs, professional fees, the amortization of intangible assets and other operational expenses. The provision for loan losses and income taxes may materially affect net income.

CAUTION ABOUT FORWARD-LOOKING STATEMENTS

The Company makes certain forward-looking statements in this report that are subject to risks and uncertainties. These forward-looking statements include statements regarding our profitability, liquidity, allowance for loan losses, interest rate sensitivity, market risk, future strategy, and financial and other goals. These forward-looking statements are generally identified by phrases such as the Company expects, the Company believes or words of similar import.

These forward-looking statements are subject to significant uncertainties because they are based upon or are affected by factors, including, without limitation, the effects of and changes in the following:

- the quality or composition of the Company s loan or investment portfolios, including collateral values and the repayment abilities of borrowers and issuers;

assumptions that underlie the Company s allowance for loan losses;

general economic and market conditions, either nationally or in the Company s market areas;

the interest rate environment;

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competitive pressures among banks and financial institutions or from companies outside the banking industry;

real estate values;

the demand for deposit, loan, and investment products and other financial services;

the demand, development and acceptance of new products and services;

the performance of vendors or other parties with which the Company does business;

time and costs associated with de novo branching, acquisitions, dispositions and similar transactions;

the realization of gains and expense savings from acquisitions, dispositions and similar transactions;

assumptions and estimates that underlie the accounting for loan pools under the shared-loss agreements;

consumer profiles and spending and savings habits;

levels of fraud in the banking industry;

the level of attempted cyber attacks in the banking industry;

the securities and credit markets;

costs associated with the integration of banking and other internal operations;

the soundness of other financial institutions with which the Company does business;

inflation;

technology; and

legislative and regulatory requirements.

These factors and additional risks and uncertainties are described in the Company s Annual Report on Form 10-K for the year ended December 31, 2013 and other reports filed from time to time by the Company with the Securities and Exchange Commission.

Although the Company believes that its expectations with respect to the forward-looking statements are based upon reliable assumptions within the bounds of its knowledge of its business and operations, there can be no assurance that actual results, performance or achievements of the Company will not differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements.

CRITICAL ACCOUNTING POLICIES

The Company s financial statements are prepared in accordance with accounting principles generally accepted in the United States (GAAP). The financial information contained within the statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained when either earning income, recognizing an expense, recovering an asset or relieving a liability. For example, the Company uses historical loss factors as one factor in determining the inherent loss that may be present in its loan portfolio. Actual losses could differ significantly from the historical factors that the Company uses. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of the Company s transactions would be the same, the timing of events that would impact its transactions could change.

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The following is a summary of the Company s critical accounting policies that are highly dependent on estimates, assumptions and judgments.

Allowance for Loan Losses on Non-covered Loans

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance is an amount that management believes is appropriate to absorb estimated losses relating to specifically identified loans, as well as probable credit losses inherent in the balance of the loan portfolio, based on an evaluation of the collectability of existing loans and prior loss experience. This quarterly evaluation also takes into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower s ability to pay. This evaluation does not include the effects of expected losses on specific loans or groups of loans that are related to future events or expected changes in economic conditions. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Bank s allowance for loan losses and may require the Bank to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

The allowance consists of specific and general components. For loans that are also 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 non-classified loans and is based on historical loss experience adjusted for qualitative factors.

A loan is considered impaired when, based on current information and events, management believes that it is more likely than not that the Bank 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, availability of current financial information, 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 construction loans by either the present value of the expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller-balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment disclosures.

Accounting for Certain Loans or Debt Securities Acquired in a Transfer

FASB ASC 310, *Receivables,* requires acquired loans to be recorded at fair value and prohibits carrying over valuation allowances in the initial accounting for acquired impaired loans. Loans carried at fair value, mortgage loans held for sale, and loans to borrowers in good standing under revolving credit arrangements are excluded from the scope of FASB ASC 310, which limits the yield that may be accreted to the excess of the undiscounted expected cash

flows over the investor s initial investment in the loan. The excess of the contractual cash flows over expected cash flows may not be recognized as an adjustment of yield. Subsequent increases in cash flows to be collected are recognized prospectively through an adjustment of the loan s yield over its remaining life. Decreases in expected cash flows are recognized as impairments through allowance for loan losses.

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The Company s acquired loans from the Suburban Federal Savings Bank (SFSB) transaction (the covered loans), subject to FASB ASC Topic 805, *Business Combinations* (formerly SFAS 141(R)), are recorded at fair value and no separate valuation allowance was recorded at the date of acquisition. FASB ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality,* applies to loans acquired in a transfer with evidence of deterioration of credit quality for which it is probable, at acquisition, that the investor will be unable to collect all contractually required payments receivable. The Company is applying the provisions of FASB ASC 310-30 to all loans acquired in the SFSB transaction. The Company has grouped loans together based on common risk characteristics including product type, delinquency status and loan documentation requirements among others.

The shared-loss agreement with the Federal Deposit Insurance Corporation (FDIC) related to the acquisition of SFSB for loans other than those secured by single family, residential 1-4 family mortgages expired March 31, 2014. These loans will continue to be accounted for in accordance with FASB ASC 310-30 as purchased credit impaired loans and were classified as non-covered loans effective April 1, 2014 (the PCI loans).

The covered loans and PCI loans are subject to the credit review standards described above for non-covered loans. If and when credit deterioration occurs subsequent to the date that the covered loans were acquired, a provision for credit loss for covered loans will be charged to earnings for the full amount without regard to the shared-loss agreements.

The Company has made an estimate of the total cash flows it expects to collect from each pool of loans, which includes undiscounted expected principal and interest. The excess of that amount over the fair value of the pool is referred to as accretable yield. Accretable yield is recognized as interest income on a constant yield basis over the life of the pool. The Company also determines each pool s contractual principal and contractual interest payments. The excess of that amount over the total cash flows that it expects to collect from the pool is referred to as nonaccretable difference, which is not accreted into income. Judgmental prepayment assumptions are applied to both contractually required payments and cash flows expected to be collected at acquisition. Over the life of the loan or pool, the Company continues to estimate cash flows expected to be collected. Subsequent decreases in cash flows expected to be collected over the life of the pool are recognized as an impairment in the current period through the allowance for loan losses. Subsequent increases in expected or actual cash flows are first used to reverse any existing valuation allowance for that loan or pool. Any remaining increase in cash flows expected to be collected is recognized as an adjustment to the accretable yield with the amount of periodic accretion adjusted over the remaining life of the pool.

FDIC Indemnification Asset

The Company is accounting for the shared-loss agreements as an indemnification asset pursuant to the guidance in FASB ASC 805. The FDIC indemnification asset is required to be measured in the same manner as the asset or liability to which it relates. The FDIC indemnification asset is measured separately from the covered loans and other real estate owned (OREO) assets because it is not contractually embedded in the covered loan and OREO assets and is not transferable should the Company choose to dispose of them. Fair value was estimated using projected cash flows available for loss sharing based on the credit adjustments estimated for each loan pool and OREO and the loss sharing percentages outlined in the shared-loss agreements. These cash flows were discounted to reflect the uncertainty of the timing and receipt of the loss sharing reimbursement from the FDIC.

Because the acquired loans are subject to shared-loss agreements and a corresponding indemnification asset exists to represent the value of expected payments from the FDIC, increases and decreases in loan accretable yield due to changing loss expectations will also have an impact to the valuation of the FDIC indemnification asset. Improvement in loss expectations will typically increase loan accretable yield and decrease the value of the FDIC indemnification asset and, in some instances, result in an amortizable premium on the FDIC indemnification asset. Increases in loss expectations will typically be recognized as impairment in the current period through allowance for loan losses while

resulting in additional noninterest income for the amount of the increase in the FDIC indemnification asset.

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Other Intangible Assets

The Company is accounting for other intangible assets in accordance with FASB ASC 350, *Intangibles Goodwill and Others*. Under FASB ASC 350, acquired intangible assets (such as core deposit intangibles) are separately recognized if the benefit of the assets can be sold, transferred, licensed, rented, or exchanged, and amortized over their useful lives The costs of purchased deposit relationships and other intangible assets, based on independent valuation by a qualified third party, are being amortized over their estimated lives. The core deposit intangible is evaluated for impairment in accordance with FASB ASC 350.

Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest and penalties associated with unrecognized tax benefits are classified as additional income taxes in the statement of income. Under FASB ASC 740, *Income Taxes,* a valuation allowance is provided when it is more likely than not that some portion of the deferred tax asset will not be realized. In management s opinion, based on a three year taxable income projection, tax strategies which would result in potential securities gains and the effects of off-setting deferred tax liabilities, it is more likely than not that the deferred tax assets are realizable.

The Company and its subsidiaries are subject to U. S. federal income tax as well as various state income taxes. All years from 2010 through 2013 are open to examination by the respective tax authorities.

Other Real Estate Owned

Real estate acquired through, or in lieu of, loan foreclosure is held for sale and is initially recorded at the fair value at the date of foreclosure net of estimated disposal costs, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of the carrying amount or the fair value less costs to sell. Revenues and expenses from operations and changes in the valuation allowance are included in other operating expenses. Costs to bring a property to salable condition are capitalized up to the fair value of the property while costs to maintain a property in salable condition are expensed as incurred.

RESULTS OF OPERATIONS

Overview

Net income was $1.7 million for the second quarter of 2014, compared with $1.6 million in the second quarter of 2013. Net income available to common shareholders was $1.5 million in the second quarter of 2014 compared with $1.3 million in the second quarter of 2013. Earnings per common share, basic and fully diluted, were $0.07 per share for the second quarter of 2014 compared with $0.06 per share for the second quarter of 2013.

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The Company reported a year-over-year reduction in noninterest expenses of $399,000, or 4.1%, for the second quarter. The most notable decline was in OREO expense, which equaled $100,000 for the second quarter of 2014, declining $402,000, or 80.1%, from the same quarter in 2013. The reduction in noninterest expenses more than offset a $368,000, or 27.5%, decline in noninterest income. Virtually all components of noninterest income were lower in the second quarter of 2014 versus the second quarter of 2013. The largest of which were a decrease of $140,000 in service charge income, of which $121,000 was due to the sale of Georgia deposits in November 2013, and a decrease of $106,000 in securities gains.

Net income was $3.4 million for the six months ended June 30, 2014 compared with $2.9 million for the first half of 2013. The $513,000 or 17.5% improvement year over year was primarily driven by a $933,000 reduction in noninterest expenses, $856,000 of which came from lower OREO expenses. Net income available to common shareholders was $3.2 million in the first half of 2014 compared with $2.4 million in the first half of 2013, an increase of 34.8%. Earnings per common share, basic and fully diluted, were $0.15 per share and $0.11 per share for the respective time frames.

Net Interest Income

The Company s operating results depend primarily on its net interest income, which is the difference between interest income on interest-earning assets, including securities and loans, and interest expense incurred on interest bearing liabilities, including deposits and other borrowed funds. Net interest income is affected by changes in the amount and mix of interest earning assets and interest bearing liabilities, referred to as a volume change. It is also affected by changes in yields earned on interest earning assets and rates paid on interest bearing deposits and other borrowed funds, referred to as a rate change.

Year-over-year, net interest income increased a modest $58,000, or 0.54%, from $10.7 million in the second quarter of 2013 to $10.8 million in the second quarter of 2014. This was primarily the result of an increase in the Company s net interest spread, from 4.25% in the second quarter of 2013 to 4.29% in the second quarter of 2014. The most significant factor influencing the positive change in the interest spread year-over-year was a 5 basis point decline in the cost of interest bearing liabilities driven by a 5 basis point decline in interest bearing deposits. During the second quarter of 2014, the Company incurred $10.7 million in long-term debt to retire its outstanding TARP preferred stock at an interest rate of 3-month LIBOR plus 350 basis points. Management anticipates significant after tax savings as the loan interest rate of 3.73% for the second quarter is tax deductible, while the dividend rate on the TARP preferred stock was 9.0%, and was not deductible for tax purposes. The effect on the margin of the added long-term debt was offset by the lower cost for FHLB borrowings of $76.8 million of 61 basis points. Additionally, the Company received a pay-off on a commercial acquisition and development (A&D) loan in the FDIC covered loan portfolio during the second quarter of 2014. The pool of A&D loans was written down to a zero carrying value in 2011, and thus any disposition or settlement results in dollar-for-dollar interest income recognition. In this instance, the Bank recognized $706,000 in interest income. The Company s net interest margin improved 3 basis points from 4.32% in the second quarter of 2013 to 4.35% for the same period in 2014.

For the six months ended June 30, 2014, net interest income of $21.1 million increased $95,000, or 0.5%, from net interest income of $21.0 million for the first six months of 2013. The Company s net interest spread improved from 4.18% for the first six months of 2013 to 4.26% for the same period in 2014. While the cost of interest bearing liabilities declined from 0.81% to 0.72% during the comparison period, the yield on earning assets declined by 1 basis point to 4.98% for the six month period in 2014. The result was a net interest margin of 4.32% for the first six months of 2014 compared with 4.25% for the first six months in 2013.

The following tables set forth, for each category of interest-earning assets and interest bearing liabilities, the average amounts outstanding, the interest earned or paid on such amounts, and the average rate earned or paid for the three and six months ended June 30, 2014 and 2013. The tables also set forth the average rate paid on total interest bearing liabilities, and the net interest margin on average total interest earning assets for the same periods. Except as indicated in the footnotes, no tax equivalent adjustments were made and all average balances are daily average balances. Any nonaccruing loans have been included in the table, as loans carrying a zero yield.

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(dollars in thousands)	Three months ended June 30, 2014			Three months ended June 30, 2013		
	Average Balance Sheet	Interest Income/ Expense	Average Rates Earned/ Paid	Average Balance Sheet	Interest Income/ Expense	Average Rates Earned/ Paid
ASSETS:						
Loans, non-covered, including fees	$ 611,065	$ 7,291	4.79%	$ 582,940	$ 7,622	5.24%
FDIC covered loans, including fees	66,722	3,264	19.62	82,177	2,745	13.40
Total loans	677,787	10,555	6.25	665,117	10,367	6.25
Interest bearing bank balances	28,795	22	0.31	20,407	14	0.27
Federal funds sold	1,379		0.10	1,951	1	0.11
Securities (taxable)	269,566	1,710	2.54	293,211	1,945	2.65
Securities (tax exempt)[1]	22,436	255	4.53	20,235	248	4.91
Total earning assets	999,963	12,542	5.03	1,000,921	12,575	5.04
Allowance for loan losses	(10,802)			(12,919)		
Non-earning assets	117,948			129,804		
Total assets	1,107,109			$ 1,117,806		
LIABILITIES AND SHAREHOLDERS EQUITY						
Demand interest bearing	$ 199,829	$ 148	0.30%	$ 242,346	$ 190	0.31%
Savings	77,057	66	0.34	81,627	70	0.34
Time deposits	558,797	1,239	0.89	536,115	1,340	1.00
Total deposits	835,683	1,453	0.70	860,088	1,600	0.75
Short-term borrowings	73	1	0.61	1,145	2	0.77
FHLB and other borrowings	81,056	162	0.80	53,765	189	1.41
Long-term debt	8,098	81	3.98			
Total interest bearing liabilities	924,910	1,697	0.74	914,998	1,791	0.79
Noninterest bearing deposits	73,738			81,056		
Other liabilities	4,526			3,936		
Total liabilities	1,003,174			999,990		
Shareholders equity	103,935			117,816		
Total liabilities and shareholders equity	$ 1,107,109			$ 1,117,806		
Net interest earnings		$ 10,845			$ 10,784	
Net interest spread			4.29%			4.25%
Net interest margin			4.35%			4.32%

(1) Income and yields are reported on a tax equivalent basis assuming a federal tax rate of 34%.

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(dollars in thousands)	Six months ended June 30, 2014			Six months ended June 30, 2013		
	Average Balance Sheet	Interest Income/ Expense	Average Rates Earned/ Paid	Average Balance Sheet	Interest Income/ Expense	Average Rates Earned/ Paid
ASSETS:						
Loans, non-covered, including fees	$ 603,381	$ 14,342	4.79%	$ 581,821	$ 15,133	5.25%
FDIC covered loans, including fees	69,731	6,225	18.00	81,951	5,404	13.30
Total loans	673,112	20,567	6.16	663,772	20,537	6.24
Interest bearing bank balances	22,586	35	0.31	18,416	22	0.24
Federal funds sold	693		0.10	5,859	3	0.10
Securities (taxable)	274,404	3,408	2.48	296,587	3,783	2.55
Securities (tax exempt)[(1)]	21,244	491	4.61	19,075	473	4.96
Total earning assets	992,039	24,501	4.98	1,003,709	24,818	4.99
Allowance for loan losses	(10,878)			(13,193)		
Non-earning assets	115,838			131,084		
Total assets	$ 1,096,999			$ 1,121,600		
LIABILITIES AND SHAREHOLDERS EQUITY						
Demand interest bearing	$ 195,341	$ 291	0.30%	$ 244,021	$ 380	0.31%
Savings	76,333	132	0.35	80,011	131	0.33
Time deposits	557,340	2,438	0.88	543,578	2,790	1.03
Total deposits	829,014	2,861	0.70	867,610	3,301	0.77
Short-term borrowings	601	2	0.52	739	3	0.76
FHLB and other borrowings	81,145	323	0.80	53,851	381	1.43
Long-term debt	4,071	81	3.98			
Total interest bearing liabilities	914,831	3,267	0.72	922,200	3,685	0.81
Noninterest bearing deposits	71,180			78,319		
Other liabilities	4,225			4,026		
Total liabilities	990,236			1,004,545		
Shareholders equity	106,763			117,055		
Total liabilities and shareholders equity	$ 1,096,999			$ 1,121,600		
Net interest earnings		$ 21,234			$ 21,133	
Net interest spread			4.26%			4.18%
Net interest margin			4.32%			4.25%

(1) Income and yields are reported on a tax equivalent basis assuming a federal tax rate of 34%.

Provision for Loan Losses

Management actively monitors the Company s asset quality and provides specific loss provisions when necessary. Provisions for loan losses are charged to income to bring the total allowance for loan losses to a level deemed appropriate by management of the Company based on such factors as historical credit loss experience, industry diversification of the commercial loan portfolio, the amount of nonperforming loans and related collateral, the volume growth and composition of the loan portfolio, current economic conditions that may affect the borrower s ability to pay and the value of collateral, the evaluation of the loan portfolio through the internal loan review function and other relevant factors. See *Allowance for Loan Losses on Non-covered Loans* in the Critical Accounting Policies section above for further discussion.

Loans are charged-off against the allowance for loan losses when appropriate. Although management believes it uses the best information available to make determinations with respect to the provision for loan losses, future adjustments may be necessary if economic conditions differ from the assumptions used in making the initial determinations.

Management also actively monitors its covered and PCI loan portfolios for impairment and necessary loan loss provisions. Provisions for these loans may be necessary due to a change in expected cash flows or an increase in expected losses within a pool of loans.

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The Company did not record a provision for loan losses in either the three month and six month periods ended June 30, 2014 or 2013 with respect to either its non-covered loan portfolio or its FDIC covered loan portfolio. For the non-covered loan portfolio, this was the direct result of continued improvement in loan quality. The Company s level of classified and impaired loans continues to remain low.

There were net charge-offs of $254,000 in the second quarter of 2014 compared with net charge-offs of $735,000 in the second quarter of 2013. Total charge-offs for the second quarter of 2014 were $446,000 compared with $1.3 million in the second quarter of 2013. Recoveries of previously charged-off loans were $192,000 for the second quarter of 2014 compared with $567,000 in the second quarter of 2013.

There were net charge-offs of $288,000 in the six months ended June 30, 2014 compared with $1.4 million in the six months ended June 30, 2013. Total charge-offs for the first six months of 2014 were $598,000 compared with $2.2 million for the same period in 2013. Recoveries were $310,000 in the six months ended June 30, 2014 compared with $813,000 in the six months ended June 30, 2013.

Noninterest Income

Noninterest income declined $368,000, or 27.5%, from the second quarter of 2013 to the second quarter of 2014. Service charge income declined $140,000, or 20.0%, over the same time frame to equal $561,000 for the second quarter. This decline was driven by a $121,000 reduction of service charge income from the Georgia branches, which were sold during the fourth quarter of 2013. Securities gains in the second quarter of 2013 were $130,000 versus $24,000 for the second quarter of 2014. Other operating income declined $143,000, or 46.4%, when comparing the quarter ended June 30, 2013 to the quarter ended June 30, 2014. Lower mortgage fee income coupled with a $39,000 gain on the sale of a covered OREO property were the key components of this decline.

For the six months ended June 30, 2014, noninterest income totaled $2.3 million, which was a $393,000, or 14.8%, decline from the first six months of 2013. The decline year over year was principally due to a $314,000 reduction in service charge income related to the sale of the Georgia branches.

Noninterest Expense

Noninterest expenses declined $399,000, or 4.1%, when comparing the second quarter of 2013 to the same period in 2014. The single largest decline was evidenced in OREO expenses. These expenses declined from $502,000 in the second quarter of 2013 to $100,000 in the second quarter of 2014. The Company benefitted from a $114,000, or 7.2%, decline in the indemnification asset amortization from the second quarter of 2013 to the second quarter of 2014. The two most significant increases in noninterest expenses evidenced from the second quarter of 2013 to the second quarter of 2014 were in other operating expenses and salaries and wages, which partially mitigated the improvement noted above. Salaries and wages increased $127,000, or 3.3%, from the second quarter of 2013 to the second quarter of 2014. This is the result of increased staffing for a wholesale mortgage unit consisting of six employees who joined the Company on April 1, 2014. Additionally, there were normal salary raises year over year. Other operating expenses increased $226,000, or 17.6%, over the same time frame. Bank franchise tax, credit expenses and external audit expenses increased $71,000, $79,000, and $54,000, respectively. These expenses collectively resulted in the majority of the increase in other operating expenses.

Noninterest expenses declined $933,000, or 4.8%, when comparing the first six months 2013 and 2014. The majority of the decline was evidenced in four categories: OREO expenses, data processing fees, amortization of intangibles, and FDIC indemnification asset amortization. OREO expenses declined $856,000, or 69.1%, during the first six months of 2014 versus the same time frame in 2013, as smaller write-downs were recognized in the first half of 2014.

Data processing fees were $131,000 lower in the first half of 2014 compared with the first six months of 2013, and intangible amortization was $177,000, or 15.6%, lower over the same time frame. These expense reductions were due to the sale of the Georgia branches. Lastly, the Company benefitted from $117,000, or 3.8%, in decline in indemnification asset amortization for the first half of 2014 versus the first half of 2013.

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Income Taxes

Income tax expense was $649,000 for the three months ended June 30, 2014, compared with income tax expense of $673,000 for second quarter of 2013, respectively. Income tax expense was $1.4 million versus $1.2 million for the first six months of 2014 and 2013, respectively.

FINANCIAL CONDITION

General

During the first six months of 2014, total assets increased $25.3 million to $1.114 billion at June 30, 2014. Total loans were $698.3 million at June 30, 2014, increasing $28.8 million since December 31, 2013. Total non-covered loans were $632.3 million at June 30, 2014 and $596.1 million at December 31, 2013. The June 30, 2014 totals include $5.2 million of loans formerly categorized under the FDIC shared-loss agreement now categorized as non-covered loans (the PCI loans). While these loans no longer have FDIC loss guaranties, they are subject to SOP 03-3 accounting rules; thus, they will not receive consideration under the loan loss reserve under the normal non-covered portfolio. Excluding the $5.2 million mentioned above, non-covered loans would have increased $31.0 million, or 5.2%, since December 31, 2013.

The Company s securities portfolio, excluding equity securities, declined $1.4 million, or 0.5%, from $294.3 million at December 31, 2013, to $293.0 million at June 30, 2014. Realized gains of $379,000 occurred during the first six months of 2014 through sales and call activity. During the first quarter of 2014, the SBA floating rate portion of the investment portfolio evidenced some unforeseen pre-payment activity, which resulted in the acceleration of unamortized premiums paid on these securities. Subsequently, management sold additional SBA floating rate securities to mitigate the pre-payment anomaly and sold some longer-term municipal securities. This was a strategic decision to mitigate duration risk in the municipal portfolio. During the second quarter, management opted to diversify some of the portfolio, purchasing AAA-rated household name corporate bonds.

The Company had cash and cash equivalents of $24.9 million and $23.8 million at June 30, 2014 and December 31, 2013, respectively. There were $2.5 million of federal funds purchased at June 30, 2014 and none at December 31, 2013, while there were no securities sold under agreement to repurchase (repos) at June 30, 2014 versus $6.0 million in repos at December 31, 2013.

The Company is required to account for the effect of market changes in the value of securities available-for-sale (AFS) under FASB ASC 320, *Investments Debt and Equity Securities*. The market value of the AFS portfolio was $266.8 million at June 30, 2014 and $265.8 million at December 31, 2013. At June 30, 2014, the Company had a net unrealized loss on the AFS portfolio of $674,000 compared with a net unrealized loss of $6.0 million at December 31, 2013. This increase is attributed to a $5.4 million increase in the municipal category. These securities exhibit more price volatility in a changing interest rate environment, in the Company s portfolio, because of their longer weighted average life, than is consistent with other categories contained within the rest of the portfolio. Municipal securities comprise 51% of the total investment portfolio at June 30, 2014.

Interest bearing deposits at June 30, 2014 were $836.1 million, an increase of $13.9 million from December 31, 2013. NOW and Savings account balances increased $12.4 million and $2.2 million, or 12.2% and 3.0%, respectively, since December 31, 2013. While time deposit account balances increased only $790,000 during the first half of 2014, the Company allowed $29.8 million in brokered time deposits to mature. This brokered funding was used, in part, to fund the sale of the Georgia branches, and the corresponding retail generation was precipitated by two promotions that management ran during the first half of 2014. This was a strategic initiative to retain core retail funding while not

hampering earnings.

FHLB advances were $76.8 million at June 30, 2014, compared with $77.1 million at December 31, 2013. The Company increased the level of FHLB advances due to the low cost nature of this funding source and to assist with funding the sale of the Georgia franchise in the fourth quarter of 2013. Long term debt totaled $10.7 million at June 30, 2014. This borrowing was entered into during April 2014, and the proceeds were used to redeem the Company s remaining outstanding TARP preferred stock.

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Shareholders equity was $102.1 million at June 30, 2014 and $106.7 million at December 31, 2013. While $11.5 million in equity was redeemed with respect to the TARP preferred stock and the associated warrant, shareholders equity declined only $4.6 million or 4.3%. The partial offset was earnings retention as well as a $3.5 million improvement in other comprehensive income related to the unrealized gains and losses in the investment portfolio.

Asset Quality non-covered assets, excluding PCI loans

The allowance for loan losses represents management s estimate of the amount appropriate to provide for probable losses inherent in the loan portfolio.

Non-covered loan quality is continually monitored, and the Company s management has established an allowance for loan losses that it believes is appropriate for the risks inherent in the loan portfolio. Among other factors, management considers the Company s historical loss experience, the size and composition of the loan portfolio, the value and appropriateness of collateral and guarantors, nonperforming loans and current and anticipated economic conditions. There are additional risks of future loan losses, which cannot be precisely quantified nor attributed to particular loans or classes of loans. Because those risks include general economic trends, as well as conditions affecting individual borrowers, the allowance for loan losses is an estimate. The allowance is also subject to regulatory examinations and determination as to appropriateness, which may take into account such factors as the methodology used to calculate the allowance and size of the allowance in comparison to peer companies identified by regulatory agencies. See *Allowance for Loan Losses on Non-covered Loans* in the Critical Accounting Policies section above for further discussion.

The Company maintains a list of non-covered loans that have potential weaknesses and thus may need special attention. This loan list is used to monitor such loans and is used in the determination of the appropriateness of the allowance for loan losses. Non-covered nonperforming assets totaled $17.6 million at June 30, 2014 and net charge-offs were $288,000 for the six months ended June 30, 2014. This compares with nonperforming assets of $18.3 million and net charge-offs of $2.5 million at and for the year ended December 31, 2013.

Nonperforming non-covered loans were $11.2 million at June 30, 2014, declining from $12.1 million at December 31, 2013. The $922,000 reduction in nonaccrual loans since December 31, 2013 was the net result of $2.1 million in additions to nonaccrual loans and $3.0 million in reductions. With respect to the reductions to nonaccrual loans, $989,000 were returned to accruing status, $529,000 were charged off, $634,000 were moved to OREO, and $823,000 were the result of payments to existing credits.

The allowance for loan losses equaled 90.8% of non-covered nonaccrual loans at June 30, 2014 compared with 86.3% at December 31, 2013. The ratio of the allowance for loan losses to total nonperforming assets was 57.8% at June 30, 2014, compared with 56.92% at December 31, 2013. The ratio of nonperforming assets to loans and OREO continued to decline. The ratio was 2.77% at June 30, 2014 versus 3.05% at December 31, 2013.

In accordance with GAAP, an individual loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due in accordance with contractual terms of the loan agreement. The Company considers all troubled debt restructured and nonaccrual loans to be impaired loans. In addition, the Company reviews all substandard and doubtful loans that are not on nonaccrual status, as well as loans with other risk characteristics, pursuant to and specifically for compliance with the accounting definition of impairment as described above. These impaired loans have been determined through analysis, appraisals, or other methods used by management.

See Note 3 to the Company s financial statements for information related to the allowance for loan losses. At June 30, 2014 and December 31, 2013, total impaired non-covered loans equaled $11.6 million and $13.8 million, respectively.

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The following table sets forth selected asset quality data, excluding FDIC covered assets and PCI loans, and ratios for the dates indicated (dollars in thousands):

	June 30, 2014	December 31, 2013
Nonaccrual loans	$ 11,183	$ 12,105
Loans past due 90 days and accruing interest		
Total nonperforming non-covered loans	11,183	12,105
OREO non-covered	6,390	6,244
Total nonperforming non-covered assets	$ 17,573	$ 18,349
Accruing troubled debt restructure loans	$ 7,533	$ 9,922
Balances		
Specific reserve on impaired loans	1,589	1,604
General reserve related to unimpaired loans	8,567	8,840
Total allowance for loan losses	10,156	10,444
Average loans during quarter, net of unearned income	606,785	585,461
Impaired loans	11,629	13,801
Non-impaired loans	615,536	582,372
Total loans, net of unearned income	627,165	596,173
Ratios		
Allowance for loan losses to loans	1.62%	1.75%
Allowance for loan losses to nonperforming assets	57.79	56.92
Allowance for loan losses to nonaccrual loans	90.82	86.28
General reserve to non-impaired loans	1.39	1.52
Nonaccrual loans to loans	1.78	2.03
Nonperforming assets to loans and OREO	2.77	3.05
Net charge-offs for quarter to average loans, annualized	0.17	0.14

The Company performs troubled debt restructures (TDR) and other various loan workouts whereby an existing loan may be restructured into multiple new loans. At June 30, 2014, the Company had 15 loans that met the definition of a TDR, which are loans that for reasons related to the debtor s financial difficulties have been restructured on terms and conditions that would otherwise not be offered or granted. Three of these loans were restructured using multiple new loans. The aggregated outstanding principal of TDR loans at June 30, 2014 was $8.2 million, of which $706,000 were classified as nonaccrual.

The primary benefit of the restructured multiple loan workout strategy is to maximize the potential return by restructuring the loan into a good loan (the A loan) and a bad loan (the B loan). The impact on interest is positive because the Bank is collecting interest on the A loan rather than potentially not collecting interest on the entire original loan structure. The A loan is underwritten pursuant to the Bank s standard requirements and graded accordingly. The B loan is classified as either doubtful or loss . An impairment analysis is performed on the B loan and, based on its results, all or a portion of the B note is charged-off or a specific loan loss reserve is established.

The Company does not modify its nonaccrual policies in this arrangement, and the A loan and the B loan stand on their own terms. At inception, this structure meets the definition of a TDR. If the loan is on nonaccrual at the time of restructure, the A loan is held on nonaccrual until six consecutive payments have been received, at which time it may be put back on an accrual status. The B loan is placed on nonaccrual. Under the terms of each loan, the borrower s payment is contractually due.

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A further breakout of nonaccrual loans, excluding covered loans, at June 30, 2014 and December 31, 2013 is below (dollars in thousands):

	June 30, 2014	December 31, 2013
Mortgage loans on real estate:		
Residential 1-4 family	$ 4,617	$ 4,229
Commercial	874	1,382
Construction and land development	5,337	5,882
Second mortgages	223	225
Multifamily		
Agriculture		205
Total real estate loans	11,051	11,923
Commercial loans	36	127
Consumer installment loans	96	55
All other loans		
Total loans	$ 11,183	$ 12,105

At June 30, 2014 the Company had seven construction and land development credit relationships in nonaccrual status. The borrowers for all of these relationships are residential land developers. All of the relationships are secured by the real estate to be developed and are in the Company s central Virginia market. The total amount of the credit exposure outstanding at June 30, 2014 was $5.3 million. These loans have either been charged-down or sufficiently reserved against to equal the current expected realizable value.

There were no charge-offs related to these relationships during the first six months of 2014. The total amount of the allowance for loan losses attributed to all eight relationships was $512,000 at June 30, 2014, or 9.6% of the total credit exposure outstanding. The Company establishes its reserves as described above in *Allowance for Loan Losses on Non-covered Loans* in the Critical Accounting Policies section. In conjunction with the impairment analysis the Company performs as part of its allowance methodology, the Company ordered appraisals for all loans with balances in excess of $250,000 unless there existed an appraisal that was not older than 12 months. The Company orders an automated valuation for balances between $100,000 and $250,000 and uses a ratio analysis for balances less than $100,000. The Company maintains detailed analysis and other information for its allowance methodology, both for internal purposes and for review by its regulators.

Asset Quality covered assets and PCI loans

Loans accounted for under FASB ASC 310-30 are generally considered accruing and performing loans as the loans accrete interest income over the estimated life of the loan. Accordingly, acquired impaired loans that are contractually past due are still considered to be accruing and performing loans.

The Company makes an estimate of the total cash flows that it expects to collect from a pool of covered loans, which include undiscounted expected principal and interest. Over the life of the loan or pool, the Company continues to estimate cash flows expected to be collected. Subsequent decreases in cash flows expected to be collected over the life of the pool are recognized as impairment in the current period through the allowance for loan losses. Subsequent increases in expected cash flows are first used to reverse any existing valuation allowance for that loan or pool. Any

remaining increase in cash flows expected to be collected is recognized as an adjustment to the yield over the remaining life of the pool.

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Capital Requirements

The determination of capital adequacy depends upon a number of factors, such as asset quality, liquidity, earnings, growth trends and economic conditions. The Company seeks to maintain a strong capital base to support its growth and expansion plans, provide stability to current operations and promote public confidence in the Company.

The federal banking regulators have defined three tests for assessing the capital strength and adequacy of banks, based on two definitions of capital. Tier 1 capital is defined as common equity, retained earnings and qualifying perpetual preferred stock, less certain intangibles. Tier 2 capital is defined as specific subordinated debt, some hybrid capital instruments and other qualifying preferred stock and a limited amount of the loan loss allowance. Total capital is defined as tier 1 capital plus tier 2 capital. Three risk-based capital ratios are computed using the above capital definitions, total assets and risk-weighted assets and are measured against regulatory minimums to ascertain adequacy. All assets and off-balance sheet risk items are grouped into categories according to degree of risk and assigned a risk-weighting and the resulting total is risk-weighted assets. Tier 1 risk-based capital is tier 1 capital divided by risk-weighted assets. Total risk-based capital is total capital divided by risk-weighted assets. The leverage ratio is tier 1 capital divided by total average assets.

The Company s ratio of total risk-based capital was 14.7% at June 30, 2014 compared with 16.8% at December 31, 2013. The tier 1 risk-based capital ratio was 13.5% at June 30, 2014 and 15.6% at December 31, 2013. The Company s tier 1 leverage ratio was 9.1% at June 30, 2014 and 9.5% at December 31, 2013. All capital ratios exceed regulatory minimums to be considered well capitalized. The decline in the ratios reflects the repayment of the TARP investment and a reduction this quarter in 0% risk-weighted assets.

The Company issued shares of Series A Preferred Stock to the United States Department of the Treasury in connection with the Company s participation in the Treasury s TARP Capital Purchase Program in December 2008. During 2013, the Company repurchased 7,000 shares of the original 17,680 shares of Series A Preferred Stock. The Company funded the repurchases through the earnings of its banking subsidiary.

On April 23, 2014, the Company repurchased the remaining 10,680 shares of Series A Preferred Stock. The Company funded the repurchase through an unsecured third-party term loan (See Note 7). The form of the repurchase was a redemption under the terms of the TARP preferred stock. The Company paid the Treasury $10.9 million, which represented 100% of the par value of the preferred stock repurchased plus accrued dividends with respect to such shares.

On June 4, 2014, the Company paid the Treasury $780,000 to repurchase the warrant associated with the Series A Preferred Stock. The Company had originally issued the warrant, which permitted Treasury to purchase 780,000 shares of the Company s common stock at an exercise price of $3.40, in December 2008. There are no other investments from the Company s participation in TARP that remain outstanding.

Liquidity

Liquidity represents the Company s ability to meet present and future financial obligations through either the sale or maturity of existing assets or the acquisition of additional funds through liability management. Liquid assets include cash, interest bearing deposits with banks, federal funds sold and certain investment securities. As a result of the Company s management of liquid assets and the ability to generate liquidity through liability funding, management believes that the Company maintains overall liquidity sufficient to satisfy its depositors requirements and meet its customers credit needs.

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The Company s results of operations are significantly affected by its ability to manage effectively the interest rate sensitivity and maturity of its interest earning assets and interest bearing liabilities. A summary of the Company s liquid assets at June 30, 2014 and December 31, 2013 was as follows (dollars in thousands):

	June 30, 2014	December 31, 2013
Cash and due from banks	$ 13,865	$ 10,857
Interest bearing bank deposits	11,029	12,978
Available for sale securities, at fair value, unpledged	225,756	185,278
Total liquid assets	$ 250,650	$ 209,113
Deposits and other liabilities	1,012,730	982,873
Ratio of liquid assets to deposits and other liabilities	24.75%	21.28%

Off-Balance Sheet Arrangements and Contractual Obligations

A summary of the contract amount of the Company s exposure to off-balance sheet and balance sheet risk as of June 30, 2014 and December 31, 2013, is as follows (dollars in thousands):

	June 30, 2014	December 31, 2013
Commitments with off-balance sheet risk:		
Commitments to extend credit	$ 72,421	$ 72,183
Standby letters of credit	7,310	9,978
Total commitments with off-balance sheet risks	$ 79,731	$ 82,161
Commitments with balance sheet risk:		
Loans held for sale	$	$ 100
Total commitments with balance sheet risks		100
Total commitments	$ 79,731	$ 82,261

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. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer s credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management s credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties. Unfunded commitments under lines of credit are commitments for possible future extensions of credit to existing customers. Those lines of credit may be drawn upon only to the total extent to which the Company is committed.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to clients. The Company holds certificates of deposit, deposit accounts, and real estate as collateral supporting those commitments for which collateral is deemed necessary.

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Item 3. ***Quantitative and Qualitative Disclosures About Market Risk***

Market risk is the risk of loss in a financial instrument arising from adverse changes in market rates or prices such as interest rates, foreign currency exchange rates, commodity prices and equity prices. The Company s primary market risk exposure is interest rate risk. The ongoing monitoring and management of interest rate risk is an important component of the Company s asset/liability management process, which is governed by policies established by its Board of Directors that are reviewed and approved annually. The Board of Directors delegates responsibility for carrying out asset/liability management policies to the Asset/Liability Committee (ALCO) of the Bank. In this capacity, ALCO develops guidelines and strategies that govern the Company s asset/liability management related activities, based upon estimated market risk sensitivity, policy limits and overall market interest rate levels and trends.

Interest rate risk represents the sensitivity of earnings to changes in market interest rates. As interest rates change, the interest income and expense streams associated with the Company s financial instruments also change, affecting net interest income, the primary component of the Company s earnings. ALCO uses the results of a detailed and dynamic simulation model to quantify the estimated exposure of net interest income to sustained interest rate changes. While ALCO routinely monitors simulated net interest income sensitivity over various periods, it also employs additional tools to monitor potential longer-term interest rate risk.

The simulation model captures the impact of changing interest rates on the interest income received and interest expense paid on all assets and liabilities reflected on the Company s balance sheet. The simulation model is prepared and updated monthly. This sensitivity analysis is compared to ALCO policy limits, which specify a maximum tolerance level for net interest income exposure over a one-year horizon, assuming no balance sheet growth, given a 200 basis point upward shift and a 200 basis point downward shift in interest rates. A parallel shift in rates over a 12-month period is assumed. The following table represents the change to net interest income given interest rate shocks up and down 100 and 200 basis points at June 30, 2014:

	Change in net interest income	
	%	$
Change in Yield curve		
+200 bp	(3.6)%	$ (1,382)
+100 bp	(2.3)	(889)
most likely	0	
100 bp	1.7	663
200 bp	(0.3)	(100)

At June 30, 2014, the Company s interest rate risk model indicated that, in a rising rate environment of 200 basis points over a 12 month period, net interest income could decrease by 3.6%. For the same time period, the interest rate risk model indicated that in a declining rate environment of 200 basis points, net interest income could decrease by 0.3%. While these percentages are subjective based upon assumptions used within the model, management believes the balance sheet is appropriately balanced with acceptable risk to changes in interest rates.

The preceding sensitivity analysis does not represent a forecast and should not be relied upon as being indicative of expected operating results. These hypothetical estimates are based upon numerous assumptions, including the nature and timing of interest rate levels such as yield curve shape, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, reinvestment or replacement of asset and liability cash flows. While assumptions are developed based upon current economic and local market conditions, the Company cannot make any assurances about the predictive nature of these assumptions, including how customer preferences or competitor influences might change.

Also, as market conditions vary from those assumed in the sensitivity analysis, actual results will also differ due to factors such as prepayment and refinancing levels likely deviating from those assumed, the varying impact of interest rate change, caps or floors on adjustable rate assets, the potential effect of changing debt service levels on customers with adjustable rate loans, depositor early withdrawals and product preference changes, and other internal and external variables. Furthermore, the sensitivity analysis does not reflect actions that ALCO might take in response to, or in anticipation of, changes in interest rates.

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Item 4. ***Controls and Procedures***

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Form 10-Q, the Company s management, with the participation of the Company s chief executive officer and its chief financial officer (the Certifying Officers), conducted evaluations of the Company s disclosure controls and procedures. As defined under Section 13a-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act), the term disclosure controls and procedures means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer s management, including the Certifying Officers, to allow timely decisions regarding required disclosures.

Based on this evaluation, the Certifying Officers have concluded that the Company s disclosure controls and procedures were effective to ensure that material information is recorded, processed, summarized and reported by management of the Company on a timely basis in order to comply with the Company s disclosure obligations under the Exchange Act and the rules and regulations promulgated under it.

Internal Control over Financial Reporting

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company s internal control over financial reporting is a process designed under the supervision of the Certifying Officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company s financial statements for external purposes in accordance with U.S. generally accepted accounting principles. There were no changes in the Company s internal control over financial reporting identified in connection with the evaluation of it that occurred during the Company s last fiscal quarter that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. ***Legal Proceedings***

There are no material pending legal proceedings, other than ordinary routine litigation incidental to the Company s business, to which the Company, including its subsidiaries, is a party or of which the property of the Company is subject.

Item 1A. ***Risk Factors***

As of the date of this report, there were no material changes to the risk factors previously disclosed in the Company s Annual Report on Form 10-K for the year ended December 31, 2013.

Item 2. ***Unregistered Sales of Equity Securities and Use of Proceeds***

None.

Item 3. ***Defaults upon Senior Securities***

None.

Item 4. ***Mine Safety Disclosures***

Not applicable

Item 5. ***Other Information***

None.

Item 6. ***Exhibits***

Exhibit No.	Description
31.1	Rule 13a-14(a)/15d-14(a) Certification for Chief Executive Officer*
31.2	Rule 13a-14(a)/15d-14(a) Certification for Chief Financial Officer*
32.1	Section 1350 Certifications*
101	Interactive Data File with respect to the following materials from the Company s Quarterly Report on Form 10-Q for the period ended June 30, 2014 formatted in Extensible Business

Reporting Language (XBRL): (i) the Consolidated Balance Sheets, (ii) the Unaudited Consolidated Statements of Income, (iii) the Unaudited Consolidated Statements of Comprehensive Income (Loss), (iv) the Unaudited Consolidated Statements of Shareholders Equity, (v) the Unaudited Consolidated Statements of Cash Flows, and (vi) Notes to Unaudited Consolidated Financial Statements*

* Filed herewith.

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SIGNATURES

Pursuant to the requirements 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.

COMMUNITY BANKERS TRUST CORPORATION
(Registrant)

/s/ Rex L. Smith, III
Rex L. Smith, III
President and Chief Executive Officer
(principal executive officer)

Date: August 8, 2014

/s/ Bruce E. Thomas
Bruce E. Thomas
Executive Vice President and Chief Financial Officer
(principal financial officer)

Date: August 8, 2014