MIDDLEFIELD BANC CORP
Form 10-Q
August 14, 2012
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20552

FORM 10 - Q

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

For the quarterly period ended June 30, 2012

Commission File Number 000-32561

Middlefield Banc Corp.
(Exact name of registrant as specified in its charter)

Ohio	34 - 1585111
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

15985 East High Street, Middlefield, Ohio 44062-9263
(Address of principal executive offices)

(440) 632-1666
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES [√] 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 definition of “large accelerated filer”, “accelerated filer”, and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [ ] Small 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 [√]

State the number of shares outstanding of each of the issuer's classes of common equity as of the latest practical date:

Class: Common Stock, without par value Outstanding at August 14, 2012: 1,977,321

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MIDDLEFIELD BANC CORP.
CONSOLIDATED BALANCE SHEET
(Dollar amounts in thousands)
(Unadited)

	June 30, 2012	December 31 2011
ASSETS		
Cash and due from banks	$30,908	$15,730
Federal funds sold	11,953	18,660
Cash and cash equivalents	42,861	34,390
Investment securities available for sale	173,446	193,977
Loans	410,868	401,880
Less allowance for loan losses	7,752	6,819
Net loans	403,116	395,061
Premises and equipment	8,598	8,264
Goodwill	4,559	4,559
Bank-owned life insurance	8,394	8,257
Accrued interest and other assets	8,866	10,043
TOTAL ASSETS	$649,840	$654,551
LIABILITIES		
Deposits:		
Noninterest-bearing demand	$65,969	$63,348
Interest-bearing demand	61,935	55,853
Money market	67,533	75,621
Savings	171,150	167,207
Time	205,142	218,933
Total deposits	571,729	580,962
Short-term borrowings	6,959	7,392
Other borrowings	16,363	16,831
Accrued interest and other liabilities	1,631	2,113
TOTAL LIABILITIES	596,682	607,298
STOCKHOLDERS' EQUITY		
Common stock, no par value; 10,000,000 shares authorized, 2,166,851 and 1,951,869 shares issued	33,944	31,240
Retained earnings	20,399	18,206
Accumulated other comprehensive income	5,549	4,541
Treasury stock, at cost; 189,530 shares	(6,734)	(6,734)
TOTAL STOCKHOLDERS' EQUITY	53,158	47,253
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$649,840	$654,551

See accompanying unaudited notes to the consolidated financial statements.

MIDDLEFIELD BANC CORP.
CONSOLIDATED STATEMENT OF INCOME
(Dollar amounts in thousands, except per share data)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
INTEREST INCOME				
Interest and fees on loans	$5,641	$5,399	$11,178	$10,700
Interest-bearing deposits in other institutions	8	2	12	4
Federal funds sold	4	4	7	13
Investment securities:				
Taxable interest	791	1,289	1,706	2,612
Tax-exempt interest	753	702	1,500	1,400
Dividends on stock	26	25	52	51
Total interest income	7,223	7,421	14,455	14,780
INTEREST EXPENSE				
Deposits	1,434	2,004	2,931	4,041
Short-term borrowings	99	59	158	118
Other borrowings	82	104	166	213
Trust preferred securities	31	137	77	273
Total interest expense	1,646	2,304	3,332	4,645
NET INTEREST INCOME	5,577	5,117	11,123	10,135
Provision for loan losses	450	700	1,050	1,565
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	5,127	4,417	10,073	8,570
NONINTEREST INCOME				
Service charges on deposit accounts	471	416	902	844
Investment securities gains (losses), net	296	(37)	296	(22)
Earnings on bank-owned life insurance	69	66	137	139
Other income	181	149	476	332
Total noninterest income	1,017	594	1,811	1,293
NONINTEREST EXPENSE				
Salaries and employee benefits	1,800	1,944	3,550	3,634
Occupancy expense	222	223	470	495
Equipment expense	201	155	371	313
Data processing costs	191	173	390	353
Ohio state franchise tax	128	97	257	225
Federal deposit insurance expense	258	272	501	497
Professional fees	186	185	400	396
Losses on other real estate owned	32	323	50	303
Other expense	1,023	920	1,834	1,781
Total noninterest expense	4,041	4,292	7,823	7,997
Income before income taxes	2,103	719	4,061	1,866
Income taxes (benefit)	463	(1)	898	144
NET INCOME	$1,640	$720	$3,163	$1,722
EARNINGS PER SHARE				
Basic	$0.85	$0.44	$1.72	$1.05

Diluted	0.85	0.44	1.72	1.05
DIVIDENDS DECLARED PER SHARE	$0.26	$0.26	$0.52	$0.52

See accompanying notes to the unaudited consolidated financial statements.

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MIDDLEFIELD BANC CORP.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(Dollar amounts in thousands)
(Unaudited)

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Net income	$1,640	$720	$3,163	$1,722
Other comprehensive income:				
Net unrealized holding gain on available for sale securities	1,884	3,754	1,824	3,508
Tax effect	(640)	(1,252)	(620)	(1,170)
Reclassification adjustment for (gains) losses included in net income	(296)	37	(296)	22
Tax effect	100	(12)	100	(7)
Total other comprehensive income	1,048	2,527	1,008	2,353
Comprehensive income	$2,688	$3,247	$4,171	$4,075

See accompanying notes to the unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(Dollar amounts in thousands, except dividend per share amount)
(Unaudited)

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2011	$31,240	$18,206	$ 4,541	$(6,734)	$ 47,253
Net income		3,163			3,163
Comprehensive income			1,008		1,008
Stock-based compensation expense (1,722 shares)	32				32
Common stock issuance (196,635 shares), net of issuance costs of $816,446	2,329				2,329
Dividend reinvestment and purchase plan (16,625 shares)	343				343
Cash dividends ($0.52 per share)		(970)			(970)
Balance, June 30, 2012	$33,944	$20,399	$ 5,549	$(6,734)	$ 53,158

See accompanying notes to the unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.
CONSOLIDATED STATEMENT OF CASH FLOWS
(Dollar amounts in thousands)
(Unaudited)

	Six Months Ended June 30, 2012	2011
OPERATING ACTIVITIES		
Net income	$3,163	$1,722
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,050	1,565
Investment securities (gains) losses, net	(296)	22
Depreciation and amortization	442	425
Amortization of premium and discount on investment securities	477	151
Amortization of deferred loan fees, net	(93)	(80)
Earnings on bank-owned life insurance	(137)	(139)
Deferred income taxes	(58)	(329)
Stock-based compensation expense	32	59
Losses on other real estate owned	50	303
Gain on sale of loans	(85)	-
Decrease in accrued interest receivable	111	118
Decrease in accrued interest payable	(97)	(35)
Decrease in prepaid federal deposit insurance	422	423
Other, net	(473)	(715)
Net cash provided by operating activities	4,508	3,490
INVESTING ACTIVITIES		
Investment securities available for sale:		
Proceeds from repayments and maturities	34,731	21,260
Proceeds from sale of securities	21,804	10,072
Purchases	(34,657)	(19,989)
Increase in loans, net	(9,328)	(14,080)
Proceeds from the sale of other real estate owned	476	414
Purchase of premises and equipment	(631)	(66)
Net cash provided by (used for) investing activities	12,395	(2,389)
FINANCING ACTIVITIES		
Net (decrease) increase in deposits	(9,233)	4,494
Decrease in short-term borrowings, net	(433)	(845)
Repayment of other borrowings	(468)	(627)
Common stock issuance	2,329	716
Proceeds from dividend reinvestment & purchase plan	343	281
Cash dividends	(970)	(850)
Net cash (used for) provided by financing activities	(8,432)	3,169
Increase in cash and cash equivalents	8,471	4,270
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	34,390	30,635

CASH AND CASH EQUIVALENTS AT END OF PERIOD	$42,861	$34,904
SUPPLEMENTAL INFORMATION		
Cash paid during the year for:		
Interest on deposits and borrowings	$3,429	$4,681
Income taxes	950	515
Non-cash investing transactions:		
Transfers from loans to other real estate owned	$316	$560

See accompanying notes to the unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

The consolidated financial statements of Middlefield Banc Corp. ("Company") include its two bank subsidiaries, The Middlefield Banking Company (“MB”) and Emerald Bank (“EB”), and a non-bank asset resolution subsidiary EMORECO, Inc. All significant inter-company items have been eliminated.

The accompanying financial statements have been prepared in accordance with U.S. generally accepted accounting principles and the instructions for Form 10-Q and Article 10 of Regulation S-X. In management’s opinion, the financial statements include all adjustments, consisting of normal recurring adjustments, that the Company considers necessary to fairly state the Company’s financial position and the results of operations and cash flows. The consolidated balance sheet at December 31, 2011, has been derived from the audited financial statements at that date but does not include all of the necessary informational disclosures and footnotes as required by U. S. generally accepted accounting principles. The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included with Middlefield’s Form 10-K for the year ended December 31, 2011 (File No. 000-32561). The results of Middlefield’s operations for any interim period are not necessarily indicative of the results of Middlefield’s operations for any other interim period or for a full fiscal year.

Recent Accounting Pronouncements

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The amendments in this Update result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments in this Update are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. For nonpublic entities, the amendments are effective for annual periods beginning after December 15, 2011. Early application by public entities is not permitted. The Company has provided the necessary disclosures in Note 4.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. The amendments in this Update improve the comparability, clarity, consistency, and transparency of financial reporting and increase the prominence of items reported in other comprehensive income. To increase the prominence of items reported in other comprehensive income and to facilitate convergence of U.S. GAAP and IFRS, the option to present components of other comprehensive income as part of the statement of changes in stockholders’ equity was eliminated. The amendments require that all non-owner changes in stockholders’ equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. All entities that report items of comprehensive income, in any period presented, will be affected by the changes in this Update. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. For nonpublic entities, the amendments are effective for fiscal years ending after December 15, 2012, and interim and annual periods thereafter. The amendments in this Update should be applied retrospectively, and early adoption is permitted. The Company has provided the necessary disclosure in the Consolidated Statement of Comprehensive Income.

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In September 2011, the FASB issued ASU 2011-08, Intangibles – Goodwill and Other Topics (Topic 350), Testing Goodwill for Impairment. The objective of this Update is to simplify how entities, both public and nonpublic, test goodwill for impairment. The amendments in the Update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Under the amendments in this Update, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The amendments in this Update apply to all entities, both public and nonpublic, that have goodwill reported in their financial statements and are effective for interim and annual goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity’s financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance. This ASU did not have a significant impact on the Company’s financial statements.

In December 2011, the FASB issued ASU 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities. The amendments in this Update affect all entities that have financial instruments and derivative instruments that are either (1) offset in accordance with either Section 210-20-45 or Section 815-10-45 or (2) subject to an enforceable master netting arrangement or similar agreement. The requirements amend the disclosure requirements on offsetting in Section 210-20-50. This information will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position, including the effect or potential effect of rights of setoff associated with certain financial instruments and derivative instruments in the scope of this Update. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. This ASU is not expected to have a significant impact on the Company’s financial statements.

In December 2011, the FASB issued ASU 2011-12, Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. In order to defer only those changes in Update 2011-05 that relate to the presentation of reclassification adjustments, the paragraphs in this Update supersede certain pending paragraphs in Update 2011-05. Entities should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before Update 2011-05. All other requirements in Update 2011-05 are not affected by this Update, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. Public entities should apply these requirements for fiscal years, and interim periods within those years, beginning after December 15, 2011. Nonpublic entities should begin applying these requirements for fiscal years ending after December 15, 2012, and interim and annual periods thereafter. This ASU is not expected to have a significant impact on the Company’s financial statements.

NOTE 2 - STOCK-BASED COMPENSATION

The Company has no unvested stock options outstanding and no unrecognized stock-based compensation costs outstanding as of June 30, 2012.

Stock option activity during the six months ended June 30, 2012 and 2011 is as follows:

	2012	Weighted-average Exercise Price	2011	Weighted-average Exercise Price
Outstanding, January 1	$ 88,774	26.81	89,077	$ 27.87
Granted	-	-	9,000	17.55
Exercised	-	-	-	-
Forfeited	(420)	36.86	(7,549)	29.22
Outstanding, June 30	88,354	26.76	90,528	26.73

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NOTE 3 - EARNINGS PER SHARE

The Company provides dual presentation of Basic and Diluted earnings per share. Basic earnings per share uses net income as reported as the numerator and the actual average shares outstanding as the denominator. Diluted earnings per share includes any dilutive effects of options, warrants, and convertible securities.

There are no convertible securities that would affect the denominator in calculating basic and diluted earnings per share. The following tables set forth the composition of the weighted-average common shares (denominator) used in the basic and diluted earnings per share computation.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
Weighted average common shares outstanding	2,108,863	1,837,301	2,031,187	1,824,431
Average treasury stock shares	(189,530)	(189,530)	(189,530)	(189,530)
Weighted average common shares and common stock equivalents used to calculate basic earnings per share	1,919,333	1,647,771	1,841,657	1,634,901
Additional common stock equivalents (stock options) used to calculate diluted earnings per share	1,872	149	1,208	75
Weighted average common shares and common stock equivalents used to calculate diluted earnings per share	1,921,205	1,647,920	1,842,865	1,634,976

Options to purchase 88,354 shares of common stock, at prices ranging from $17.55 to $40.24, were outstanding during the three and six months ended June 30, 2012. Of those options, 9,000 were considered dilutive based on the market price exceeding the strike price. The remaining 79,354 options had no dilutive effect on the earnings per share.

During the three and six months ended June 30, 2011, the remaining options to purchase 81,528 shares of common stock at prices ranging from $22.33 to $40.24 were outstanding but were not included in the computation of diluted earnings per share as they were anti-dilutive due to the strike price being greater than the average market price for the six months ended June 30, 2011. Total options to purchase shares of common stock were 90,528 at prices ranging from $17.55 to $40.24 for the six months ended June 30, 2011.

NOTE 4 - FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants at the measurement date. The three broad levels defined by U.S. generally accepted accounting principles are as follows:

Level I: Quoted prices are available in active markets for identical assets or liabilities as of the reported date.

Level II: Pricing inputs are other than the quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities includes items for which quoted prices are available but traded less frequently and items that are fair-valued using other financial instruments, the parameters of which can be directly observed.

Level III: Assets and liabilities that have little to no pricing observability as of the reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

The following tables present the assets measured on a recurring basis on the Consolidated Balance Sheet at their fair value as of June 30, 2012 and December 31, 2011 by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	June 30, 2012			
(Dollar amounts in thousands)	Level I	Level II	Level III	Total
Assets Measured on a Recurring Basis:				
U.S. government agency securities	$-	$13,572	$-	$13,572
Obligations of states and political subdivisions	-	88,587	-	88,587
Mortgage-backed securities in government-sponsored entities		64,274		64,274
Private-label mortgage-backed securities	-	6,262	-	6,262
Total debt securities	-	172,695	-	172,695
Equity securities in financial institutions	5	746	-	751
Total	$5	$173,441	$-	$173,446

	December 31, 2011			
	Level I	Level II	Level III	Total
Assets Measured on a Recurring Basis:				
U.S. government agency securities	$-	$31,933	$-	$31,933
Obligations of states and political subdivisions	-	88,400	-	88,400
Mortgage-backed securities in government-sponsored entities		65,573	-	65,573
Private-label mortgage-backed securities	-	7,321	-	7,321
Total debt securities	-	193,227	-	193,227
Equity securities in financial institutions	5	745	-	750
Total	$5	$193,972	$-	$193,977

The Company obtains fair values from an independent pricing service which represent either quoted market prices for the identical securities (Level 1 inputs) or fair values determined by pricing models using a market approach that considers observable market data, such as interest rate volatilities, LIBOR yield curve, credit spreads and prices from market makers and live trading systems (Level 2).

Financial instruments are considered Level III when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. In addition to these unobservable inputs, the valuation models for Level III financial instruments typically also rely on a number of inputs that are readily observable either directly or indirectly. Level III financial instruments also include those for which the determination of fair value requires significant management judgment or estimation. The Company has no securities considered to be Level III as of June 30, 2012.

The Company uses prices compiled by third party vendors due to the recent stabilization in the markets along with improvements in third party pricing methodology that have narrowed the variances between third party vendor prices and actual market prices.

The following tables present the assets measured on a nonrecurring basis on the Consolidated Balance Sheet at their fair value as of June 30, 2012 and December 31, 2011, by level within the fair value hierarchy. Impaired loans that are collateral dependent are written down to fair value through the establishment of specific reserves. Techniques used to value the collateral that secure the impaired loan include: quoted market prices for identical assets classified as Level I inputs; observable inputs, employed by certified appraisers, for similar assets classified as Level II inputs. In cases where valuation techniques included inputs that are unobservable and are based on estimates and assumptions developed by management based on the best information available under each circumstance, the asset valuation is classified as Level III inputs.

(Dollar amounts in thousands)	June 30, 2012 Level I	Level II	Level III	Total
Assets Measured on a non-recurring Basis:				
Impaired loans	$-	$-	$6,061	$6,061
Other real estate owned	-	-	1,986	1,986

	December 31, 2011 Level I	Level II	Level III	Total
Assets Measured on a non-recurring Basis:				
Impaired loans	$-	$-	$13,581	$13,581
Other real estate owned	-	-	2,196	2,196

The following table presents additional quantitative information about assets measured at fair value on a non-recurring basis and for which the Company uses Level III inputs to determine fair value:

Quantitative Information about Level III Fair Value Measurements

(unaudited, in thousands)	Estimate	Valuation Techniquest	Unobservable Input	Range (Weighted Average)			
June 30, 2012							
Impaired loans	$ 6,061	Appraisal of collateral (1)	Appraisal adjustments (2)	0%	to	-75.0%	(-36.4%)
			Liquidation expenses (2)	0%	to	-21.9%	(-2.2%)
Other real estate owned	$ 1,986	Appraisal of collateral (1), (3)					

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various level 3 inputs which are not identifiable.
(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.
(3) Includes qualitative adjustments by management and estimated liquidation expenses.

The estimated fair value of the Company's financial instruments is as follows:

	June 30, 2012 Carrying Value (in thousands)	Level I	Level II	Level III	Total Fair Value
Financial assets:					
Cash and cash equivalents	$42,861	$42,861	$-	$-	$42,861
Investment securities Available for sale	173,446	5	173,441	-	173,446
Net loans	403,116	-	-	394,490	394,490
Bank-owned life insurance	8,394	8,394		-	8,394
Federal Home Loan Bank stock	1,887	1,887		-	1,887
Accrued interest receivable	2,123	2,123	-	-	2,123
Financial liabilities:					
Deposits	$571,729	$366,587	$-	$210,321	$576,908
Short-term borrowings	6,959	6,959	-	-	6,959
Other borrowings	16,363	-	-	16,769	16,769
Accrued interest payable	548	548	-	-	548

	June 30, 2012		December 31, 2011	
	Carrying Value (in thousands)	Fair Value	Carrying Value	Fair Value
Financial assets:				
Cash and cash equivalents	$42,861	$42,861	$34,390	$34,390
Investment securities Available for sale	173,446	173,446	193,977	193,977
Net loans	403,116	394,490	395,061	382,542
Bank-owned life insurance	8,394	8,394	8,257	8,257
Federal Home Loan Bank stock	1,887	1,887	1,887	1,887
Accrued interest receivable	2,123	2,123	2,234	2,234
Financial liabilities:				
Deposits	$571,729	$576,908	$580,962	$587,178
Short-term borrowings	6,959	6,959	7,392	7,392
Other borrowings	16,363	16,769	16,831	17,327
Accrued interest payable	548	548	645	645

Financial instruments are defined as cash, evidence of ownership interest in an entity, or a contract which creates an obligation or right to receive or deliver cash or another financial instrument from/to a second entity on potentially favorable or unfavorable terms.

Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing parties other than in a forced liquidation sale. If a quoted market price is available for a financial instrument, the estimated fair value would be calculated based upon the market price per trading unit of the instrument.

If no readily available market exists, the fair value estimates for financial instruments should be based upon management's judgment regarding current economic conditions, interest rate risk, expected cash flows, future estimated losses, and other factors as determined through various option pricing formulas or simulation modeling. Since many of these assumptions result from judgments made by management based upon estimates which are inherently uncertain, the resulting estimated fair values may not be indicative of the amount realizable in the sale of a particular financial instrument. In addition, changes in assumptions on which the estimated fair values are based may have a significant impact on the resulting estimated fair values.

As certain assets such as deferred tax assets and premises and equipment are not considered financial instruments, the estimated fair value of financial instruments would not represent the full value of the Company.

The Company employed simulation modeling in determining the estimated fair value of financial instruments for which quoted market prices were not available based upon the following assumptions:

Cash and Cash Equivalents, Federal Home Loan Bank Stock, Accrued Interest Receivable, Accrued Interest Payable, and Short-Term Borrowings
The fair value is equal to the current carrying value.

Bank-Owned Life Insurance
The fair value is equal to the cash surrender value of the life insurance policies.

Investment Securities Available-for-sale
The fair value of investment securities is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities. Fair value for certain private-label collateralized mortgage obligations was determined utilizing discounted cash flow models, due to the absence of a current market to provide reliable market quotes for the instruments.

Loans
The fair value is estimated by discounting future cash flows using current market inputs at which loans with similar terms and qualities would be made to borrowers of similar credit quality. Where quoted market prices were available, primarily for certain residential mortgage loans, such market rates were used as estimates for fair value.

Deposits and Other Borrowings
The fair values of certificates of deposit and other borrowed funds are based on the discounted value of contractual cash flows. The discount rates are estimated using rates currently offered for similar instruments with similar remaining maturities. Demand, savings, and money market deposits are valued at the amount payable on demand as of year-end.

Commitments to Extend Credit
These financial instruments are generally not subject to sale, and estimated fair values are not readily available. The carrying value, represented by the net deferred fee arising from the unrecognized commitment or letter of credit, and the fair value, determined by discounting the remaining contractual fee over the term of the commitment using fees currently charged to enter into similar agreements with similar credit risk, are not considered material for disclosure.

NOTE 5 - INVESTMENT SECURITIES AVAILABLE-FOR-SALE

The amortized cost and fair values of securities available-for-sale are as follows:

(Dollar amounts in thousands)	June 30, 2012 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	$12,989	$583	$-	$13,572
Obligations of states and political subdivisions:				
Taxable	8,201	956	-	9,157
Tax-exempt	74,842	4,611	(23)	79,430
Mortgage-backed securities in government-sponsored entities	62,437	1,863	(26)	64,274
Private-label mortgage-backed securities	5,819	484	(41)	6,262
Total debt securities	164,288	8,497	(90)	172,695
Equity securities in financial institutions	750	1	-	751
Total	$165,038	$8,498	$(90)	$173,446

	December 31, 2011 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	$31,520	$427	$(14)	$31,933
Obligations of states and political subdivisions:				
Taxable	8,207	766	-	8,973
Tax-exempt	75,807	3,681	(61)	79,427
Mortgage-backed securities in government-sponsored entities	63,808	1,819	(54)	65,573
Private-label mortgage-backed securities	7,005	411	(95)	7,321
Total debt securities	186,347	7,104	(224)	193,227
Equity securities in financial institutions	750	-	-	750
Total	$187,097	$7,104	$(224)	$193,977

The amortized cost and fair value of debt securities at June 30, 2012, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollar amounts in thousands)	Amortized Cost	Fair Value
Due in one year or less	$2,784	$2,842
Due after one year through five years	5,809	6,149
Due after five years through ten years	15,903	16,866
Due after ten years	139,792	146,838
Total	$164,288	$172,695

Proceeds from the sales of securities available-for-sale and the gross realized gains and losses are as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
Proceeds from sales	$21,804	$-	$21,804	$10,072
Gross realized gains	308	-	308	15
Gross realized losses	(12)	(37)	(12)	(37)

Gross realized losses for the three and six months ended June 30, 2011 were the result of OTTI taken on equity securities.

Investment securities with an approximate carrying value of $52,927,000 and $55,809,000 at June 30, 2012 and 2011, respectively, were pledged to secure deposits and other purposes as required by law.

The following tables show the Company’s gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position.

	June 30, 2012					
	Less than Twelve Months		Twelve Months or Greater		Total	
(Dollar amounts in thousands)	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Obligations of states and political subdivisions	$742	$ (12)	$289	$ (11)	$1,031	$ (23)
Mortgage-backed securities in government-sponsored entities	8,523	(26)	-	-	8,523	(26)
Private-label mortgage-backed securities	335	(6)	358	(35)	693	(41)
Total	$9,600	$ (44)	$647	$ (46)	$10,247	$ (90)

	December 31, 2011					
	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government agency securities	$1,986	$ (14)	$-	$ -	$1,986	$ (14)
Obligations of states and political subdivisions	2,707	(40)	919	(21)	3,626	(61)
Mortgage-backed securities in government-sponsored entities	8,992	(54)	-	-	8,992	(54)
Private-label mortgage-backed securities	1,628	(42)	398	(53)	2,026	(95)
Total	$15,313	$ (150)	$1,317	$ (74)	$16,630	$ (224)

There were 10 and 51 securities that were considered temporarily impaired at June 30, 2012 and 2011.

On a quarterly basis, the Company performs an assessment to determine whether there have been any events or economic circumstances indicating that a security with an unrealized loss has suffered other-than-temporary impairment (“OTTI”). A debt security is considered impaired if the fair value is less than its amortized cost basis at the reporting date. OTTI losses are recognized in earnings when the Company has the intent to sell the debt security or it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost basis. However, even if the Company does not expect to sell a debt security, it must evaluate expected cash flows to be received and determine if a credit loss has occurred.

An unrealized loss is generally deemed to be other than temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. As a result the credit loss component of an OTTI is recorded as a component of investment securities gains (losses) in the accompanying Consolidated Statement of Income, while the remaining portion of the impairment loss is recognized in other comprehensive income, provided the Company does not intend to sell the underlying debt security and it is “more likely than not” that the Company will not have to sell the debt security prior to recovery.

Debt securities issued by U.S. government agencies, U.S. government-sponsored enterprises, and state and political subdivisions accounted for more than 96% of the total available-for-sale portfolio as of June 30, 2012 and no credit losses are expected, given the explicit and implicit guarantees provided by the U.S. federal government and the lack of significant unrealized loss positions within the obligations of state and political subdivisions security portfolio. The Company’s assessment was concentrated mainly on private-label collateralized mortgage obligations of approximately $6.3 million for which the Company evaluates credit losses on a quarterly basis. The gross unrealized gain position related to these private-label collateralized mortgage obligations amounted to $484,000 and the gross unrealized loss position was $41,000 on June 30, 2012. The Company considered the following factors in determining whether a credit loss exists and the period over which the debt security is expected to recover:

- The length of time and the extent to which the fair value has been less than the amortized cost basis.

- Changes in the near term prospects of the underlying collateral of a security such as changes in default rates, loss severity given default and significant changes in prepayment assumptions;

- The level of cash flows generated from the underlying collateral supporting the principal and interest payments of the debt securities; and

- Any adverse change to the credit conditions and liquidity of the issuer, taking into consideration the latest information available about the overall financial condition of the issuer, credit ratings, recent legislation and government actions affecting the issuer's industry and actions taken by the issuer to deal with the present economic climate.

For the three and six months ended June 30, 2012, there were no available-for-sale debt securities with an unrealized loss that suffered OTTI.

NOTE 6 - LOANS AND RELATED ALLOWANCE FOR LOAN LOSSES

Major classifications of loans are summarized as follows (in thousands):

	June 30, 2012	December 31, 2011
Commercial and industrial	$65,651	$59,185
Real estate - construction	20,409	21,545
Real estate - mortgage:		
Residential	207,080	208,139
Commercial	113,383	108,502
Consumer installment	4,345	4,509
	410,868	401,880
Less allowance for loan losses	(7,752)	(6,819)
Net loans	$403,116	$395,061

The Company's primary business activity is with customers located within its local trade area, eastern Geauga County, and contiguous counties to the north, east, and south. The Company also serves the central Ohio market with offices in Dublin and Westerville, Ohio. Commercial, residential, consumer, and agricultural loans are granted. Although the Company has a diversified loan portfolio, loans outstanding to individuals and businesses are dependent upon the local economic conditions in the Company's immediate trade area.

The following tables summarize the primary segments of the loan portfolio and allowance for loan losses (in thousands):

			Real Estate- Mortgage			
June 30, 2012	Commercial and industrial	Real estate- construction	Residential	Commercial	Consumer installment	Total
Loans:						
Individually evaluated for impairment	$ 4,065	$ 649	$4,619	$ 6,420	$ -	$15,753
Collectively evaluated for impairment	61,586	19,760	202,461	106,963	4,345	395,115
Total loans	$ 65,651	$ 20,409	$207,080	$ 113,383	$ 4,345	$410,868

December 31, 2011	Commercial and industrial	Real estate- construction	Real estate- Mortgage Residential	Real estate- Mortgage Commercial	Consumer installment	Total
Loans:						
Individually evaluated for impairment	$ 4,492	$ 867	$4,882	$ 6,491	$ -	$16,732
Collectively evaluated for impairment	54,693	20,678	203,257	102,011	4,509	385,148
Total loans	$ 59,185	$ 21,545	$208,139	$ 108,502	$ 4,509	$401,880

June 30, 2012	Commercial and industrial	Real estate- construction	Real Estate- Mortgage Residential	Real Estate- Mortgage Commercial	Consumer installment	Total
Allowance for loan losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 680	$ 237	$691	$ 59	$ -	$1,667
Collectively evaluated for impairment	946	267	3,418	1,433	21	6,085
Total ending allowance balance	$ 1,626	$ 504	$4,109	$ 1,492	$ 21	$7,752

December 31, 2011	Commercial and industrial	Real estate- construction	Real Estate- Mortgage Residential	Real Estate- Mortgage Commercial	Consumer installment	Total
Allowance for loan losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 595	$ 237	$685	$ 185	$ -	$1,702
Collectively evaluated for impairment	701	201	3,046	1,121	48	5,117
Total ending allowance balance	$ 1,296	$ 438	$3,731	$ 1,306	$ 48	$6,819

The Company's loan portfolio is segmented to a level that allows management to monitor risk and performance. The portfolio is segmented into Commercial and Industrial ("C&I"), Real Estate Construction, Real Estate - Mortgage which is further segmented into Residential and Commercial real estate, and Consumer Installment Loans. The C&I loan segment consists of loans made for the purpose of financing the activities of commercial customers. The residential mortgage loan segment consists of loans made for the purpose of financing the activities of residential homeowners. The commercial mortgage loan segment consists of loans made for the purposed of financing the activities of commercial real estate owners and operators. The consumer loan segment consists primarily of installment loans and overdraft lines of credit connected with customer deposit accounts.

Management evaluates individual loans in all of the commercial segments for possible impairment if the loan is greater than $150,000 and if the loan either is in nonaccrual status, or is risk rated Special Mention or Substandard. Loans are considered to be impaired when, based on current information and events, it is probable that the Company 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 evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. 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. The Company does not separately evaluate individual consumer and residential mortgage loans for impairment, unless such loans are part of a larger relationship that is impaired.

Once the determination has been made that a loan is impaired, the determination of whether a specific allocation of the allowance is necessary is measured by comparing the recorded investment in the loan to the fair value of the loan using one of three methods: (a) the present value of expected future cash flows discounted at the loan's effective interest rate; (b) the loan's observable market price; or (c) the fair value of the collateral less selling costs. The method is selected on a loan-by loan basis, with management primarily utilizing the fair value of collateral method. The evaluation of the need and amount of a specific allocation of the allowance and whether a loan can be removed from impairment status is made on a quarterly basis. The Company's policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition.

The following tables present impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary (in thousands):

June 30, 2012

Impaired Loans	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial and industrial	$ 742	$742	$ -
Real estate - construction	203	203	-
Real estate - mortgage:			
Residential	2,667	2,668	-
Commercial	1,653	1,661	-
Consumer installment	26	26	-
With an allowance recorded:			
Commercial and industrial	$ 453	$453	$ 248
Real estate - construction	217	217	125
Real estate - mortgage:			
Residential	267	269	266
Commercial	711	712	239
Consumer installment	-	-	-
Total:			
Commercial and industrial	$ 1,195	$1,195	$ 248
Real estate - construction	420	420	125
Real estate - mortgage:			
Residential	2,934	2,937	266
Commercial	2,364	2,373	239
Consumer installment	26	26	-

December 31, 2011

Impaired Loans	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial and industrial	$ 1,172	$ 1,172	$ -
Real estate - construction	4,250	4,250	-
Real estate - mortgage:			
Residential	3,188	3,193	-
Commercial	2,528	2,536	-
Consumer installment	24	24	-
With an allowance recorded:			
Commercial and industrial	$ 465	$ 465	$ 196
Real estate - construction	271	271	125
Real estate - mortgage:			
Residential	-	-	-
Commercial	2,555	2,560	551
Total:			
Commercial and industrial	$ 1,637	$ 1,637	$ 196
Real estate - construction	4,521	4,521	125
Real estate - mortgage:			
Residential	3,188	3,193	-
Commercial	5,083	5,096	551
Consumer installment	24	24	-

The following tables present average recorded investment and related interest income recognized for impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary (in thousands):

	For the Three Months Ended June 30, 2012		For the Three Months Ended June 30, 2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Total:				
Commercial and industrial	$ 1,488	$ 21	$ 4,337	$ 80
Real estate - construction	446	-	616	-
Real estate - mortgage:				
Residential	2,872	61	574	33
Commercial	2,124	98	3,762	35
Consumer installment	27	-	-	-

	For the Six Months Ended June 30, 2012		For the Six Months Ended June 30, 2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Total:				
Commercial and industrial	$ 1,440	$ 33	$ 3,604	-
Real estate - construction	1,796	1	617	82
Real estate - mortgage:				
Residential	2,998	88	583	-
Commercial	3,190	124	3,430	45
Consumer installment	26	1	-	102

Management uses a nine point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first five categories are considered not criticized, and are aggregated as "Pass" rated. The criticized rating categories used by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due are considered Substandard. Any portion of a loan that has been charged off is placed in the Loss category.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Company has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as bankruptcy, repossession, or death occurs to raise awareness of a possible credit event. The Company's Commercial Loan Officers are responsible for the timely and accurate risk rating of the loans in their portfolios at origination and on an ongoing basis. The Credit Department performs an annual review of all commercial relationships $200,000 or greater. Confirmation of the appropriate risk grade is included in the review on an ongoing basis. The Company has an experienced Loan Review Department that continually reviews and assesses loans within the portfolio. The Company engages an external consultant to conduct loan reviews on a semi-annual basis. Generally, the external consultant reviews commercial relationships greater than $250,000 and/or criticized relationships greater than $125,000. Detailed reviews, including plans for resolution, are performed on loans classified as Substandard on a quarterly basis. Loans in the Special Mention and Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

The following table presents the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard and Doubtful within the internal risk rating system (in thousands):

	Pass	Special Mention	Substandard	Doubtful	Total Loans
June 30, 2012					
Commercial and industrial	$61,224	$634	$ 3,793	$-	$65,651
Real estate - construction	19,734	-	675	-	20,409
Real estate - mortgage:					
Residential	192,198	910	13,972	-	207,080
Commercial	104,925	2,165	6,293	-	113,383
Consumer installment					