MIDDLEFIELD BANC CORP
Form 10-Q
August 07, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20552

FORM 10 - Q

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

OF 1934

For the quarterly period ended June 30, 2013

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 practicable date:

Class: Common Stock, without par value

Outstanding at August 7, 2013: 2,021,912

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MIDDLEFIELD BANC CORP.

CONSOLIDATED BALANCE SHEET

(Dollar amounts in thousands)

(Unaudited)

	June 30, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$22,052	$33,568
Federal funds sold	18,377	11,778
Cash and cash equivalents	40,429	45,346
Investment securities available for sale	179,757	194,472
Loans	412,399	408,433
Less allowance for loan losses	7,749	7,779
Net loans	404,650	400,654
Premises and equipment, net	8,583	8,670
Goodwill	4,559	4,559
Core deposit intangible	173	195
Bank-owned life insurance	8,675	8,536
Accrued interest and other assets	10,966	7,856
TOTAL ASSETS	$657,792	$670,288
LIABILITIES		
Deposits:		
Noninterest-bearing demand	$83,095	$75,912
Interest-bearing demand	58,238	63,915
Money market	77,563	81,349
Savings	180,875	175,406
Time	185,648	196,753
Total deposits	585,419	593,335
Short-term borrowings	5,407	6,538
Other borrowings	12,635	12,970
Accrued interest and other liabilities	1,781	2,008
TOTAL LIABILITIES	605,242	614,851
STOCKHOLDERS' EQUITY		
Common stock, no par value; 10,000,000 shares authorized, 2,210,822 and 2,181,763 shares issued	34,694	34,295
Retained earnings	24,780	22,485
Accumulated other comprehensive income (loss)	(190)	5,391
Treasury stock, at cost; 189,530 shares	(6,734)	(6,734)

TOTAL STOCKHOLDERS' EQUITY	52,550	55,437
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$657,792	$670,288

See accompanying notes to unaudited consolidated financial statements.

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MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF INCOME

(Dollar amounts in thousands, except per share data)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2013	2012	2013	2012
INTEREST INCOME				
Interest and fees on loans	$5,550	$5,641	$11,122	$11,178
Interest-bearing deposits in other institutions	9	8	17	12
Federal funds sold	4	4	8	7
Investment securities:				
Taxable interest	625	791	1,299	1,706
Tax-exempt interest	744	753	1,477	1,500
Dividends on stock	15	26	38	52
Total interest income	6,947	7,223	13,961	14,455
INTEREST EXPENSE				
Deposits	1,219	1,434	2,516	2,931
Short-term borrowings	47	99	99	158
Other borrowings	44	82	90	166
Trust preferred securities	47	31	81	77
Total interest expense	1,357	1,646	2,786	3,332
NET INTEREST INCOME	5,590	5,577	11,175	11,123
Provision for loan losses	300	450	613	1,050
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	5,290	5,127	10,562	10,073
NONINTEREST INCOME				
Service charges on deposit accounts	511	471	958	902
Investment securities gains (losses), net	(10)	296	175	296
Earnings on bank-owned life insurance	75	69	143	137
Gain on sale of loans	-	-	-	85
Other income	243	181	411	391
Total noninterest income	819	1,017	1,687	1,811
NONINTEREST EXPENSE				
Salaries and employee benefits	1,906	1,800	3,777	3,550
Occupancy expense	248	222	522	470
Equipment expense	186	201	375	371
Data processing costs	187	191	400	390

Ohio state franchise tax	149	128	303	257
Federal deposit insurance expense	64	258	218	501
Professional fees	291	186	567	400
(Gain) loss on sale of other real estate owned	(13)	32	(5)	50
Advertising expense	111	112	223	232
Other real estate expense	90	213	196	273
Directors Fees	133	106	238	182
Other expense	596	592	1,135	1,147
Total noninterest expense	3,948	4,041	7,949	7,823
Income before income taxes	2,161	2,103	4,300	4,061
Income taxes	476	463	958	898
NET INCOME	$1,685	$1,640	$3,342	$3,163
EARNINGS PER SHARE				
Basic	$0.84	$0.85	$1.66	$1.72
Diluted	0.83	0.85	1.66	1.72
DIVIDENDS DECLARED PER SHARE	$0.26	$0.26	$0.52	$0.52

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(Dollar amounts in thousands)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2013	2012	2013	2012
Net income	$1,685	$1,640	$3,342	$3,163
Other comprehensive income (loss):				
Net unrealized holding gain (loss) on available for sale securities	(6,760)	1,884	(8,281)	1,824
Tax effect	2,298	(640)	2,815	(620)
Reclassification adjustment for (gains) losses included in net income	10	(296)	(175)	(296)
Tax effect	(3)	100	60	100
Total other comprehensive income (loss)	(4,455)	1,048	(5,581)	1,008
Comprehensive income (loss)	$(2,770)	$2,688	$(2,239)	$4,171

See accompanying notes to 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 (Loss)	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2012	$ 34,295	$ 22,485	$ 5,391	$ (6,734)	$ 55,437
Net income		3,342			3,342
Comprehensive loss			(5,581)		(5,581)
Common stock issuance (13,320 shares), net of issuance cost ($139)	74				74
Dividend reinvestment and purchase plan (15,739 shares)	440				440
Stock options exercised	(115)				(115)
Cash dividends ($0.52 per share)		(1,047)			(1,047)
Balance, June 30, 2013	$ 34,694	$ 24,780	$ (190)	$ (6,734)	$ 52,550

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF CASH FLOWS

(Dollar amounts in thousands)

(Unaudited)

	Six Months Ended June 30, 2013	2012
OPERATING ACTIVITIES		
Net income	$3,342	$3,163
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	613	1,050
Investment securities (gains) losses, net	(175)	(296)
Depreciation and amortization	449	442
Amortization of premium and discount on investment securities	457	477
Accretion of deferred loan fees, net	(119)	(93)
Origination of loans held for sale	-	(1,084)
Proceeds from sale of loans held for sale	-	1,169
Gain on sale of loans	-	(85)
Earnings on bank-owned life insurance	(143)	(137)
Deferred income taxes	103	(58)
(Gain) loss on sale of other real estate owned	(5)	50
(Increase) decrease in accrued interest receivable	(88)	111
Decrease in accrued interest payable	(32)	(97)
(Increase) decrease in prepaid federal deposit insurance	(73)	422
Other, net	57	(558)
Net cash provided by operating activities	4,386	4,476
INVESTING ACTIVITIES		
Investment securities available for sale:		
Proceeds from repayments and maturities	12,992	34,731
Proceeds from sale of securities	8,135	21,804
Purchases	(15,150)	(34,657)
Increase in loans, net	(5,465)	(9,328)
Proceeds from the sale of other real estate owned	465	476
Purchase of premises and equipment	(250)	(631)
Net cash provided by investing activities	727	12,395
FINANCING ACTIVITIES		
Net decrease in deposits	(7,916)	(9,233)
Decrease in short-term borrowings, net	(1,131)	(433)
Repayment of other borrowings	(335)	(468)
Common stock issuance	74	2,329
Stock options exercised	(115)	32

Proceeds from dividend reinvestment & purchase plan	440	343
Cash dividends	(1,047)	(970)
Net cash used for financing activities	(10,030)	(8,400)
Increase (decrease) in cash and cash equivalents	(4,917)	8,471
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	45,346	34,390
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$40,429	$42,861
SUPPLEMENTAL INFORMATION		
Cash paid during the year for:		
Interest on deposits and borrowings	$2,818	$3,429
Income taxes	900	950
Non-cash investing transactions:		
Transfers from loans to other real estate owned	$975	$316

See accompanying notes to 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, 2012, 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 financial statements should be read in conjunction with the financial statements and notes thereto included with the Company’s Form 10-K for the year ended December 31, 2012 (File No. 000-32561). The results of the Company’s operations for any interim period are not necessarily indicative of the results of the Company’s operations for any other interim period or for a full fiscal year.

Recent Accounting Pronouncements

In April 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2013-07, *Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting*. The amendments in this Update are being issued to clarify when an entity should apply the liquidation basis of accounting. In addition, the guidance provides principles for the recognition and measurement of assets and liabilities and requirements for financial statements prepared using the liquidation basis of accounting. The amendments require an entity to prepare its financial statements using the liquidation basis of accounting when liquidation is imminent. Liquidation is imminent when the likelihood is remote that the entity will return from liquidation and either (a) a plan for liquidation is approved by the person or persons with the authority to make such a plan effective and the likelihood is remote that the execution of the plan will be blocked by other parties or (b) a plan for liquidation is being imposed by other forces (for example, involuntary bankruptcy). If a plan for liquidation was specified in the entity's governing documents from the entity's inception (for example, limited-life entities), the entity should apply the liquidation basis of accounting only if the approved plan for liquidation differs from the plan for liquidation that was specified at the entity's inception. The amendments are effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. Entities should apply the requirements prospectively from the day that liquidation becomes imminent. Early adoption is permitted. Entities that use the liquidation basis of accounting as of the effective date in accordance with other Topics (for example, terminating employee benefit plans) are not required to apply the amendments. Instead, those entities should continue to apply the guidance in those other Topics until they have completed liquidation.

In June 2013, the FASB issued ASU 2013-08, *Financial Services – Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements.* The amendments in this Update affect the scope, measurement, and disclosure requirements for investment companies under U.S. GAAP. The amendments do all of the following: 1. Change the approach to the investment company assessment in Topic 946, clarify the characteristics of an investment company, and provide comprehensive guidance for assessing whether an entity is an investment Company. 2. Require an investment company to measure noncontrolling ownership interests in other investment companies at fair value rather than using the equity method of accounting. 3. Require the following additional disclosures: (a) the fact that the entity is an investment company and is applying the guidance in Topic 946, (b) information about changes, if any, in an entity's status as an investment company, and (c) information about financial support provided or contractually required to be provided by an investment company to any of its investees. The amendments in this Update are effective for an entity's interim and annual reporting periods in fiscal years that begin after December 15, 2013. Earlier application is prohibited.

In July 2013, the FASB ASU 2013-09, *Fair Value Measurement (Topic 820): Deferral of the Effective Date of Certain Disclosures for Nonpublic Employee Benefit Plans in Update No. 2011-04.* The amendments in this Update apply to certain quantitative disclosure requirements for an employee benefit plan, other than those plans that are subject to the Securities and Exchange Commission's filing requirements (hereafter "nonpublic employee benefit plan"), that holds investments in its plan sponsor's own nonpublic entity equity securities, including equity securities of its plan sponsor's nonpublic affiliated entities and that are within the scope of the disclosure requirements contained in FASB Accounting Standards Update No. 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 defer indefinitely the effective date of certain required disclosures in Update 2011-04 (Topic 820) of quantitative information about the significant unobservable inputs used in Level 3 fair value measurements for investments held by a nonpublic employee benefit plan in its plan sponsor's own nonpublic entity equity securities, including equity securities of its plan sponsor's nonpublic affiliated entities. The amendments in this Update do not defer the effective date for those certain quantitative disclosures for other nonpublic entity equity securities held in the nonpublic employee benefit plan or any qualitative disclosures. The deferral in this amendment is effective upon issuance for financial statements that have not been issued.

In July 2013, the FASB issued ASU 2013-10, *Derivatives and Hedging (Topic 815): Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes.* The amendments in this Update permit the Fed Funds Effective Swap Rate (OIS) to be used as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to UST and LIBOR. The amendments also remove the restriction on using different benchmark rates for similar hedges. The amendments are effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013.

In July 2013, the FASB issued ASU 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists.* This Update applies to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. For nonpublic entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted.

NOTE 2 - STOCK-BASED COMPENSATION

The Company had no unvested stock options outstanding or unrecognized stock-based compensation costs outstanding as of June 30, 2013 and 2012.

Stock option activity during the six months ended June 30 is as follows:

	2013	Weighted-average Exercise Price	2012	Weighted-average Exercise Price
Outstanding, January 1	79,693	$ 26.81	88,774	$ 26.81
Exercised	(19,761)	24.09	-	-
Forfeited	-	-	(9,081)	22.94
Outstanding, June 30	59,932	28.29	79,693	27.25
Exercisable June 30	59,932	28.29	79,693	27.25

NOTE 3 - EARNINGS PER SHARE

The Company provides dual presentation of basic and diluted earnings per share. Basic earnings per share is calculated by dividing net income by the average shares outstanding. Diluted earnings per share adds the dilutive effects of options, warrants, and convertible securities to average shares outstanding.

The following table sets 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,	
	2013	2012	2013	2012
Weighted average common shares outstanding	2,206,794	2,108,863	2,198,033	2,031,187
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	2,017,264	1,919,333	2,008,503	1,841,657
Additional common stock equivalents (stock options) used to calculate diluted earnings per share	6,697	1,872	8,557	1,208
Weighted average common shares and common stock equivalents used to calculate diluted earnings per share	2,023,961	1,921,205	2,017,060	1,842,865

Options to purchase 61,132 shares of common stock, at prices ranging from $17.55 to $40.24, were outstanding during the three months ended June 30, 2013. Of those options, 31,833 were considered dilutive based on the market price exceeding the strike price. The remaining 29,299 options had no dilutive effect on earnings per share. For the six months ended June 30, 2013, 49,394 options were considered dilutive. The remaining 11,738 options had no dilutive effect on earnings per share.

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.

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. GAAP established a fair value hierarchy that prioritizes the use of inputs used in valuation methodologies into the following three levels:

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 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, 2013			
(Dollar amounts in thousands)	Level I	Level II	Level III	Total
Assets Measured on a Recurring Basis:				
U.S. government agency securities	$ -	$26,588	$ -	$26,588
Obligations of states and political subdivisions	-	89,718	-	89,718
Mortgage-backed securities in government- sponsored entities		58,413		58,413

Private-label mortgage-backed securities	-	4,288	-	4,288
Total debt securities	-	179,007	-	179,007
Equity securities in financial institutions	5	745	-	750
Total	$ 5	$179,752	$ -	$179,757

	December 31, 2012			
	Level I	Level II	Level III	Total
Assets Measured on a Recurring Basis:				
U.S. government agency securities	$ -	$24,960	$ -	$24,960
Obligations of states and political subdivisions	-	92,596	-	92,596
Mortgage-backed securities in government- sponsored entities		71,102	-	71,102
Private-label mortgage-backed securities	-	5,064	-	5,064
Total debt securities	-	193,722	-	193,722
Equity securities in financial institutions	5	745	-	750
Total	$ 5	$194,467	$ -	$194,472

The Company obtains fair values from an independent pricing service which represent either quoted market prices for the identical securities (Level I 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 II).

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, 2013 or December 31, 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 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.

The Company values other real estate owned at the estimated fair value of the underlying collateral less expected selling costs. Such values are estimated primarily using appraisals and reflect a market value approach. Due to the significance of the Level 3 inputs, other real estate owned has been classified as Level III.

(Dollar amounts in thousands)	June 30, 2013 Level I	Level II	Level III	Total
Assets Measured on a non-recurring Basis:				
Impaired loans	$ -	$ -	$ 15,287	$ 15,287
Other real estate owned	-	-	2,361	2,361

	December 31, 2012 Level I	Level II	Level III	Total
Assets Measured on a non-recurring Basis:				
Impaired loans	$ -	$ -	$ 17,600	$ 17,600
Other real estate owned	-	-	1,846	1,846

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:

(unaudited, in thousands)	Quantitative Information about Level III Fair Value Measurements Estimate		Valuation Techniquest	Unobservable Input	Range (Weighted Average)
	June 30, 2013	December 31, 2012			
Impaired loans	$ 15,287	17,600	Appraisal of collateral (1)	Appraisal adjustments (2)	0% to -68.0% (-31.4 %)
				Liquidation expenses (2)	0% to -45.8% (-2.2 %)
Other real estate owned	$ 2,361	1,846	Appraisal of collateral (1), (3)	Appraisal adjustments (2)	0% to -10.0% (-7.5 %)

(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, 2013 Carrying Value (in thousands)	Level I	Level II	Level III	Total Fair Value
Financial assets:					
Cash and cash equivalents	$40,429	$40,429	$-	$-	$40,429
Investment securities					
Available for sale	179,757	5	179,752	-	179,757
Net loans	404,650	-	-	408,322	408,322
Bank-owned life insurance	8,675	8,675		-	8,675
Federal Home Loan Bank stock	1,887	1,887		-	1,887
Accrued interest receivable	2,251	2,251	-	-	2,251
Financial liabilities:					
Deposits	$585,419	$399,771	$-	$187,825	$587,596
Short-term borrowings	5,407	5,407	-	-	5,407
Other borrowings	12,635	-	-	12,860	12,860
Accrued interest payable	460	460	-	-	460

	December 31, 2012 Carrying Value (in thousands)	Level I	Level II	Level III	Total Fair Value
Financial assets:					
Cash and cash equivalents	$45,346	$45,346	$-	$-	$45,346
Investment securities					
Available for sale	194,472	5	194,467	-	194,472
Net loans	400,654	-	-	390,206	390,206
Bank-owned life insurance	8,536	8,536	-	-	8,536
Federal Home Loan Bank stock	1,887	1,887	-	-	1,887
Accrued interest receivable	2,163	2,163	-	-	2,163
Financial liabilities:					
Deposits	$593,335	$396582	$-	$196,122	$592,704
Short-term borrowings	6,538	6,538	-	-	6,538
Other borrowings	12,970	-	-	13,337	13,337

Accrued interest payable	492	492	-	-	492

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.

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 Borrowed Funds

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 period 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 – ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table presents the changes in accumulated other comprehensive income by component net of tax for the three and six months ended June 30, 2013 and 2012:

	Unrealized gains on available for sale securities (a)
Balance as of December 31, 2012	$ 5,391
Other comprehensive loss before reclassification	(1,004)
Amount reclassified from accumulated other comprehensive income	(122)
Period change	(1,126)
Balance at March 31, 2013	4,265
Other comprehensive loss before reclassification	(4,462)
Amount reclassified from accumulated other comprehensive income	7
Period change	(4,455)
Balance at June 30, 2013	$ (190)
Balance as of December 31, 2011	$ 4,541
Other comprehensive loss before reclassification	(40)
Amount reclassified from accumulated other comprehensive income	-
Period change	(40)
Balance at March 31, 2012	4,501
Other comprehensive loss before reclassification	1,244
Amount reclassified from accumulated other comprehensive income	(196)
Period change	1,048
Balance at June 30, 2012	$ 5,549

(a) All amounts are net of tax. Amounts in parentheses indicate debits.

The following tables present significant amounts reclassified out of each component of accumulated other comprehensive inocme:

Details about other comprehensive income	Amount Reclassified from Accumulated Other Comprehensive Income For the Three Months Ended June 30, 2013	2012	Affected Line Item in the Statement Where Net Income is Presented
Unealized gains on available for sale securities			
	$ 10	$ 296	Investment securities gains, net
	(3)	(100)	Income taxes
	$ 7	$ 196	Net of tax

(a) Amounts in parentheses indicate debits to net income

Details about other comprehensive income	Accumulated Other Comprehensive Income For the Six Months Ended June 30, 2013	2012	Affected Line Item in the Statement Where Net Income is Presented
Unealized gains on available for sale securities			
	$ (175)	$ (296)	Investment securities gains, net
	60	100	Income taxes
	$ (115)	$ (196)	Net of tax

(a) Amounts in parentheses indicate debits to net income

NOTE 6 - 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, 2013 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	$27,020	$ 343	$ (775)	$26,588
Obligations of states and political subdivisions:				
Taxable	5,367	344	(6)	5,705
Tax-exempt	84,455	2,273	(2,715)	84,013
Mortgage-backed securities in government-sponsored entities	58,557	809	(953)	58,413
Private-label mortgage-backed securities	3,895	393	-	4,288
Total debt securities	179,294	4,162	(4,449)	179,007
Equity securities in financial institutions	750	-	-	750
Total	$180,044	$ 4,162	$ (4,449)	$179,757

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	$24,485	$ 566	$ (91)	$24,960
Obligations of states and political subdivisions:				
Taxable	6,888	738	-	7,626
Tax-exempt	80,391	4,683	(104)	84,970
Mortgage-backed securities in government-sponsored entities	69,238	1,929	(65)	71,102
Private-label mortgage-backed securities	4,553	511	-	5,064
Total debt securities	185,555	8,427	(260)	193,722
Equity securities in financial institutions	750	-	-	750
Total	$186,305	$ 8,427	$ (260)	$194,472

The amortized cost and fair value of debt securities at June 30, 2013, 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	$2,781	$2,835
Due after one year through five years	4,125	4,331
Due after five years through ten years	22,550	22,894
Due after ten years	149,838	148,947
Total	$179,294	$179,007

Proceeds from the sales of securities available-for-sale and the gross realized gains and losses for the three and six months ended June 30 are as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2013	2012	2013	2012

Proceeds from sales	$533	$21,804	$8,135	$21,804
Gross realized gains	-	308	204	308
Gross realized losses	(10)	(12)	(29)	(12)

Investment securities with an approximate carrying value of $70.4 million and $62.5 million at June 30, 2013 and December 31, 2012, 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.

(Dollar amounts in thousands)	June 30, 2013 Less than Twelve Months Fair Value	Gross Unrealized Losses	Twelve Months or Greater Fair Value	Gross Unrealized Losses	Total Fair Value	Gross Unrealized Losses
U.S. government agency securities	$17,131	$ (775)	$ -	$ -	$17,131	$ (775)
Obligations of states and political subdivisions	$21,713	$ (2,721)	$ -	$ -	$21,713	$ (2,721)
Mortgage-backed securities in government-sponsored entities	34,542	(953)	-	-	34,542	(953)
Total	$73,386	$ (4,449)	$ -	$ -	$73,386	$ (4,449)

	December 31, 2012 Less than Twelve Months Fair Value	Gross Unrealized Losses	Twelve Months or Greater Fair Value	Gross Unrealized Losses	Total Fair Value	Gross Unrealized Losses
U.S. government agency securities	$9,938	$ (91)	$ -	$ -	$9,938	$ (91)
Obligations of states and political subdivisions	9,240	(104)	-	-	9,240	(104)
Mortgage-backed securities in government-sponsored entities	12,353	(65)	-	-	12,353	(65)
Total	$31,531	$ (260)	$ -	$ -	$31,531	$ (260)

There were 84 securities considered temporarily impaired at June 30, 2013.

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. The Company assesses whether the unrealized loss is other-than-temporary.

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 97% of the total available-for-sale portfolio as of June 30, 2013 and no credit losses are expected, given the explicit and implicit guarantees provided by the U.S. federal government and the lack of prolonged 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 $3.9 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 $393,000 on June 30, 2013. 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 six months ended June 30, 2013 and 2012, there were no available-for-sale debt securities with an unrealized loss that suffered OTTI.

NOTE 7 - LOANS AND RELATED ALLOWANCE FOR LOAN LOSSES

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

	June 30, 2013	December 31, 2012
Commercial and industrial	$49,898	$62,188
Real estate - construction	24,084	22,522
Real estate - mortgage:		
Residential	199,250	203,872
Commercial	135,006	115,734
Consumer installment	4,161	4,117
	412,399	408,433
Less allowance for loan losses	7,749	7,779
Net loans	$404,650	$400,654

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.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff generally are reported at their outstanding unpaid principal balances net of the allowance for loan losses. Interest income is recognized as income when earned on the accrual method. The accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions, the borrower’s financial condition is such that collection of interest is doubtful. Interest received on nonaccrual loans is recorded as income or applied against principal according to management’s judgment as to the collectability of such principal.

Loan origination fees and certain direct loan origination costs are being deferred and the net amount amortized as an adjustment of the related loan's yield. Management is amortizing these amounts over the contractual life of the related loans.

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

			Real Estate- Mortgage			
June 30, 2013	Commercial and industrial	Real estate-construction	Residential	Commercial	Consumer installment	Total
Individually evaluated for impairment	$ 2,310	$ 3,927	$4,905	$ 6,506	$ 10	$17,658
Collectively evaluated for impairment	47,588	20,157	194,345	128,500	4,151	394,741
Total loans	$ 49,898	$ 24,084	$199,250	$ 135,006	$ 4,161	$412,399

			Real estate- Mortgage			
December 31, 2012	Commercial and industrial	Real estate-construction	Residential	Commercial	Consumer installment	Total
Loans:						
Individually evaluated for impairment	$ 4,592	$ 3,993	$5,761	$ 6,914	$ 28	$21,288
Collectively evaluated for impairment	57,596	18,529	198,111	108,820	4,089	387,145
Total loans	$ 62,188	$ 22,522	$203,872	$ 115,734	$ 4,117	$408,433

			Real Estate- Mortgage			
June 30, 2013	Commercial and industrial	Real estate-construction	Residential	Commercial	Consumer installment	Total
Allowance for loan losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 323	$ 814	$754	$ 479	$ -	$2,370
Collectively evaluated for impairment	552	377	2,872	1,526	51	5,378
Total ending allowance balance	$ 875	$ 1,191	$3,626	$ 2,005	$ 51	$7,748

			Real Estate- Mortgage			
December 31, 2012	Commercial and industrial	Real estate-construction	Residential	Commercial	Consumer installment	Total
Allowance for loan losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 1,189	$ 933	$600	$ 960	$ 6	$3,688

Collectively evaluated for impairment	543	190	2,272	1,031	55	4,091
Total ending allowance balance	$ 1,732	$ 1,123	$2,872	$ 1,991	$ 61	$7,779

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 and is greater than 90 days past due. 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 table presents 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, 2013			
Impaired Loans	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial and industrial	$ 1,177	$ 1,177	$ -
Real estate - construction	150	150	-
Real estate - mortgage:			
Residential	2,627	2,741	-
Commercial	3,506	3,506	-
Consumer installment	4	4	-
Total	$ 7,464	$ 7,578	$ -
With an allowance recorded:			
Commercial and industrial	$ 1,133	$ 1,133	$ 323
Real estate - construction	3,777	3,777	814
Real estate - mortgage:			
Residential	2,278	2,317	754
Commercial	3,000	3,000	479
Consumer installment	6	6	1
Total	$ 10,194	$ 10,233	$ 2,371
Total:			
Commercial and industrial	$ 2,310	$ 2,310	$ 323
Real estate - construction	3,927	3,927	814
Real estate - mortgage:			
Residential	4,905	5,058	754
Commercial	6,506	6,506	479
Consumer installment	10	10	1
Total	$ 17,658	$ 17,811	$ 2,371

December 31, 2013

Impaired Loans

	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial and industrial	$ 1,230	$ 1,229	$ -
Real estate - construction	308	308	-
Real estate - mortgage:			
Residential	2,716	2,729	-
Commercial	4,143	4,164	-
Consumer installment	11	11	-
Total	$ 8,408	$ 8,441	$ -
With an allowance recorded:			
Commercial and industrial	$ 3,362	$ 3,367	$ 1,189
Real estate - construction	3,685	3,685	933
Real estate - mortgage:			
Residential	3,045	3,054	600
Commercial	2,771	2,776	960
Consumer installment	17	17	6
Total	$ 12,880	$ 12,899	$ 3,688
Total:			
Commercial and industrial	$ 4,592	$ 4,596	$ 1,189
Real estate - construction	3,993	3,993	933
Real estate - mortgage:			
Residential	5,761	5,783	600
Commercial	6,914	6,940	960
Consumer installment	28	28	6
Total	$ 21,288	$ 21,340	$ 3,688

The following table presents interest income by class, recognized on impaired loans:

	For the Three Months Ended June 30, 2013		For the Six Months Ended June 30, 2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Total:				

Commercial and industrial	$2,643	$ 15	$2,687	$ 70
Real estate - construction	3,850	58	3,499	95
Real estate - mortgage:				
Residential	5,274	69	4,937	143
Commercial	6,669	106	6,018	216
Consumer installment	14	1	18	1

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2012		June 30, 2012	
	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	-	-	