CITIZENS FINANCIAL SERVICES INC
Form 10-Q
August 08, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2013
Or

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

For the transition period from_____________________ to ___________________

Commission file number 0-13222

CITIZENS FINANCIAL SERVICES, INC.
(Exact name of registrant as specified in its charter)

PENNSYLVANIA	23-2265045
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

15 South Main Street
Mansfield, Pennsylvania 16933
(Address of principal executive offices)(Zip Code)

Registrant's telephone number, including area code: (570) 662-2121

Indicate by check mark whether the registrant (1) has filed all reports to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes __X__ No_____

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 __X__ No_____

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

Large accelerated filer ____ Accelerated filer _X__

Non-accelerated filer ____ Smaller reporting company ____
(Do not check if a smaller reporting company)

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

The number of outstanding shares of the Registrant's Common Stock, as of July 30, 2013, was 3,038,511.

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CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED BALANCE SHEET
(UNAUDITED)

(in thousands except share data)		June 30 2013		December 31 2012
ASSETS:				
Cash and due from banks:				
Noninterest-bearing	$	7,928	$	12,307
Interest-bearing		3,642		14,026
Total cash and cash equivalents		11,570		26,333
Available-for-sale securities		307,935		310,252
Loans held for sale		796		1,458
Loans (net of allowance for loan losses:				
2013, $6,989 and 2012, $6,784)		508,747		495,679
Premises and equipment		11,396		11,521
Accrued interest receivable		3,821		3,816
Goodwill		10,256		10,256
Bank owned life insurance		14,427		14,177
Other assets		10,128		8,935
TOTAL ASSETS	$	879,076	$	882,427
LIABILITIES:				
Deposits:				
Noninterest-bearing	$	86,852	$	89,494
Interest-bearing		661,162		647,602
Total deposits		748,014		737,096
Borrowed funds		33,993		46,126
Accrued interest payable		964		1,143
Other liabilities		7,223		8,587
TOTAL LIABILITIES		790,194		792,952
STOCKHOLDERS' EQUITY:				
Preferred Stock				
$1.00 par value; authorized 3,000,000 shares June 30, 2013 and December 31, 2012;				
none issued in 2013 or 2012		-		-
Common stock				
$1.00 par value; authorized 15,000,000 shares; issued 3,305,517 at June 30, 2013 and				
3,161,324 at December 31, 2012		3,306		3,161
Additional paid-in capital		23,545		16,468
Retained earnings		69,538		71,813
Accumulated other comprehensive (loss) income		(713)		4,631
Treasury stock, at cost: 267,006 shares at June 30, 2013				

and 262,921 shares at December 31, 2012	(6,794)	(6,598)
TOTAL STOCKHOLDERS' EQUITY	88,882	89,475
TOTAL LIABILITIES AND		
STOCKHOLDERS' EQUITY	$ 879,076	$ 882,427

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENT OF INCOME
(UNAUDITED)

	Three Months Ended June 30		Six Months Ended June 30,	
(in thousands, except share and per share data)	2013	2012	2013	2012
INTEREST INCOME:				
Interest and fees on loans	$ 7,141	$ 7,439	$ 14,278	$ 14,904
Interest-bearing deposits with banks	9	1	19	6
Investment securities:				
Taxable	936	1,237	1,899	2,434
Nontaxable	844	920	1,713	1,874
Dividends	18	16	38	32
TOTAL INTEREST INCOME	8,948	9,613	17,947	19,250
INTEREST EXPENSE:				
Deposits	1,287	1,555	2,615	3,221
Borrowed funds	310	393	668	806
TOTAL INTEREST EXPENSE	1,597	1,948	3,283	4,027
NET INTEREST INCOME	7,351	7,665	14,664	15,223
Provision for loan losses	75	105	225	210
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	7,276	7,560	14,439	15,013
NON-INTEREST INCOME:				
Service charges	1,079	1,129	2,103	2,207
Trust	169	151	370	324
Brokerage and insurance	121	75	213	225
Investment securities gains, net	98	213	294	321
Gains on loans sold	50	131	161	185
Earnings on bank owned life insurance	126	126	250	250
Other	100	104	204	233
TOTAL NON-INTEREST INCOME	1,743	1,929	3,595	3,745
NON-INTEREST EXPENSES:				
Salaries and employee benefits	2,795	2,668	5,600	5,421
Occupancy	312	314	654	624
Furniture and equipment	113	96	215	202
Professional fees	188	224	417	492
FDIC insurance	113	115	225	238
Pennsylvania shares tax	182	160	365	326
Other	1,129	988	2,178	2,090
	4,832	4,565	9,654	9,393

TOTAL NON-INTEREST EXPENSES								
Income before provision for income taxes		4,187		4,924		8,380		9,365
Provision for income taxes		907		1,171		1,813		2,163
NET INCOME	$	3,280	$	3,753	$	6,567	$	7,202
PER COMMON SHARE DATA:								
Net Income - Basic	$	1.08	$	1.23	$	2.17	$	2.35
Net Income - Diluted	$	1.08	$	1.23	$	2.16	$	2.35
Cash Dividends Paid	$	0.271	$	0.283	$	0.543	$	0.562

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	2013	2012	2013	2012
Net income	$ 3,280	$ 3,753	$ 6,567	$ 7,202
Other comprehensive income (loss):				
Change in unrealized gains on available for sale securities	(6,656)	741	(8,032)	318
Income tax effect	2,263	(252)	2,731	(108)
Change in unrecognized pension cost	128	-	128	-
Income tax effect	(44)	-	(44)	-
Change in unrealized loss on interest rate swap	51	45	101	66
Income tax effect	(17)	(15)	(34)	(23)
Less: Reclassification adjustment for investment security gains included in net income	(98)	(213)	(294)	(321)
Income tax effect	33	72	100	109
Other comprehensive income (loss), net of tax	(4,340)	378	(5,344)	41
Comprehensive income (loss)	$ (1,060)	$ 4,131	$ 1,223	$ 7,243

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)

(in thousands)	Six Months Ended June 30, 2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 6,567	$ 7,202
Adjustments to reconcile net income to net		
cash provided by operating activities:		
Provision for loan losses	225	210
Depreciation and amortization	216	211
Amortization and accretion of investment securities	1,234	1,196
Deferred income taxes	9	28
Investment securities gains, net	(294)	(321)
Earnings on bank owned life insurance	(250)	(250)
Originations of loans held for sale	(11,801)	(14,241)
Proceeds from sales of loans held for sale	12,624	14,426
Realized gains on loans sold	(161)	(185)
Increase in accrued interest receivable	(5)	(179)
Decrease in accrued interest payable	(179)	(290)
Other, net	413	(269)
Net cash provided by operating activities	8,598	7,538
CASH FLOWS FROM INVESTING ACTIVITIES:		
Available-for-sale securities:		
Proceeds from sales	15,773	16,654
Proceeds from maturity and principal repayments	49,651	68,914
Purchase of securities	(72,372)	(90,754)
Proceeds from redemption of regulatory stock	513	245
Purchase of regulatory stock	(207)	(1,405)
Net increase in loans	(13,246)	(9,679)
Purchase of premises and equipment	(203)	(117)
Proceeds from sale of foreclosed assets held for sale	-	345
Net cash used in investing activities	(20,091)	(15,797)
CASH FLOWS FROM FINANCING ACTIVITIES:		

Net increase in deposits	10,918	4,774
Repayments of long-term borrowings	(10,800)	(4,110)
Net decrease in short-term borrowed funds	(1,333)	(2,706)
Purchase of treasury and restricted stock	(380)	(637)
Dividends paid	(1,675)	(1,726)
Net cash used in financing activities	(3,270)	(4,405)
Net decrease in cash and cash equivalents	(14,763)	(12,664)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	26,333	30,432
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 11,570	$ 17,768
Supplemental Disclosures of Cash Flow Information:		
Interest paid	$ 3,462	$ 4,317
Income taxes paid	$ 2,295	$ 2,095
Loans transferred to foreclosed property	$ 54	$ 123

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CITIZENS FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 - Basis of Presentation

Citizens Financial Services, Inc., (individually and collectively with its direct and indirect subsidiaries, the "Company") is a Pennsylvania corporation organized as the holding company of its wholly owned subsidiary, First Citizens Community Bank (the "Bank"), and the Bank's subsidiary, First Citizens Insurance Agency, Inc. ("First Citizens Insurance").

The accompanying consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission ("SEC") and in conformity with U.S. generally accepted accounting principles. Because this report is based on an interim period, certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. Certain of the prior year amounts have been reclassified to conform with the current year presentation. Such reclassifications had no effect on net income or stockholders' equity. All material inter-company balances and transactions have been eliminated in consolidation.

In the opinion of management of the Company, the accompanying interim financial statements for the periods ended June 30, 2013 and 2012 include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial condition and the results of operations for the period. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. The financial performance reported for the Company for the six month period ended June 30, 2013 is not necessarily indicative of the results to be expected for the full year. This information should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

Note 2 - Earnings per Share

The following table sets forth the computation of earnings per share. Earnings per share calculations give retroactive effect to stock dividends declared by the Company.

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Net income applicable to common stock	$3,280,000	$3,753,000	$6,567,000	$7,202,000
Basic earnings per share computation				
Weighted average common shares outstanding	3,031,279	3,058,663	3,032,491	3,063,500
Earnings per share - basic	$1.08	$1.23	$2.17	$2.35
Diluted earnings per share computation				
Weighted average common shares outstanding for basic earnings per share	3,031,279	3,058,663	3,032,491	3,063,500
Add: Dilutive effects of restricted stock	1,578	1,409	781	624
	3,032,857	3,060,072	3,033,272	3,064,124

Weighted average common shares outstanding for dilutive earnings per share				
Earnings per share - diluted	$1.08	$1.23	$2.16	$2.35

For the three months ended June 30, 2013 there were no anti-dilutive securities, compared to 2,447 shares for the three months ended June 30, 2012 related to the restricted stock program that were excluded from the diluted earnings per share calculations since they were anti-dilutive. For the six months ended June 30, 2013 and 2012, 1,415 and 4,115 shares, respectively, related to the restricted stock program were excluded from the diluted earnings per share calculations since they were anti-dilutive.

Note 3 - Income Tax Expense

Income tax expense is less than the amount calculated using the statutory tax rate, primarily as a result of tax-exempt income earned from state and municipal securities and loans and investments in tax credits.

Note 4 – Investments

The amortized cost and fair value of investment securities at June 30, 2013 and December 31, 2012 were as follows (in thousands):

June 30, 2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. agency securities	$ 138,674	$ 875	$ (1,669)	$ 137,880
U.S. treasury securities	11,845	-	(374)	11,471
Obligations of state and political subdivisions	93,203	2,939	(965)	95,177
Corporate obligations	21,161	356	(551)	20,966
Mortgage-backed securities in government sponsored entities	40,313	844	(277)	40,880
Equity securities in financial institutions	832	729	-	1,561
Total available-for-sale securities	$ 306,028	$ 5,743	$ (3,836)	$ 307,935

December 31, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. agency securities	$ 125,125	$ 2,150	$ (41)	$ 127,234
U.S. treasury securities	4,922	25	-	4,947
Obligations of state and political subdivisions	95,288	5,721	(134)	100,875
Corporate obligations	21,699	452	(42)	22,109
Mortgage-backed securities in government sponsored entities	52,072	1,728	(127)	53,673
Equity securities in financial institutions	912	502	-	1,414
Total available-for-sale securities	$ 300,018	$ 10,578	$ (344)	$ 310,252

The following table shows the Company's gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time, which individual securities have been in a continuous unrealized loss position, at June 30, 2013 and December 31, 2012 (in thousands). As of June 30, 2013, the Company owned 74 securities whose fair value was less than their cost basis.

June 30, 2013	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. agency securities	$ 79,007	$ (1,669)	$ -	$ -	$ 79,007	$ (1,669)
U.S. treasury securities	11,471	(374)	-	-	11,471	(374)
Obligations of state and political subdivisions	19,910	(965)	-	-	19,910	(965)
Corporate obligations	12,018	(551)	-	-	12,018	(551)
Mortgage-backed securities in government sponsored entities	23,272	(266)	47	(11)	23,319	(277)
Total securities	$ 145,678	$ (3,825)	$ 47	$ (11)	$ 145,725	$ (3,836)
December 31, 2012						
U.S. agency securities	$ 6,016	$ (41)	$ -	$ -	$ 6,016	$ (41)
Obligations of states and political subdivisions	7,981	(134)	-	-	7,981	(134)
Corporate obligations	10,972	(42)	-	-	10,972	(42)
Mortgage-backed securities in government sponsored entities	8,651	(127)	-	-	8,651	(127)
Total securities	$ 33,620	$ (344)	$ -	$ -	$ 33,620	$ (344)

As of June 30, 2013, the Company's investment securities portfolio contained unrealized losses on agency securities issued or backed by the full faith and credit of the United States government or are generally viewed as having the implied guarantee of the U.S. government, U.S treasuries, obligations of states and political subdivisions, corporate obligations and mortgage backed securities in government sponsored entities. For fixed maturity investments management considers whether the present value of cash flows expected to be collected are less than the security's amortized cost basis (the difference defined as the credit loss), the magnitude and duration of the decline, the reasons underlying the decline and the Company's intent to sell the security or whether it is more likely than not that the Company would be required to sell the security before its anticipated recovery in market value, to determine whether the loss in value is other than temporary. Once a decline in value is determined to be other than temporary, if the Company does not intend to sell the security, and it is more likely than not that it will not be required to sell the security before recovery of the security's amortized cost basis, the charge to earnings is limited to the amount of credit loss. Any remaining difference between fair value and amortized cost (the difference defined as the non-credit portion) is recognized in other comprehensive income, net of applicable taxes. Otherwise, the entire difference between fair value and amortized cost is charged to earnings. For equity securities where the fair value has been significantly below cost for one year, the Company's policy is to recognize an impairment loss unless sufficient evidence is available that the decline is not other than temporary and a recovery period can be predicted. The Company has concluded that any impairment of its investment securities portfolio outlined in the above table is not other than temporary and is the result of interest rate changes, sector credit rating changes, or company-specific rating changes that are not expected to result in the non-collection of principal and interest during the period.

Proceeds from sales of securities available-for-sale for the six months ended June 30, 2013 and 2012 were \$15,773,000 and \$16,654,000, respectively. For the three months ended June 30, 2013 and 2012, there were sales of \$11,917,000 and \$5,418,000, respectively, of available-for-sale securities. The gross gains and losses were as follows (in thousands):

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Gross gains	$ 238	$ 213	$ 434	$ 321
Gross losses	(140)	-	(140)	-
Net gains	$ 98	$ 213	$ 294	$ 321

Investment securities with an approximate carrying value of $189.9 million and $193.3 million at June 30, 2013 and December 31, 2012, respectively, were pledged to secure public funds and certain other deposits.

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.   The amortized cost and fair value of debt securities at June 30, 2013, by contractual maturity, are shown below (in thousands):

	Amortized Cost	Fair Value
Available-for-sale debt securities:		
Due in one year or less	$ 10,605	$ 10,697
Due after one year through five years	93,632	93,674
Due after five years through ten years	84,743	83,978
Due after ten years	116,216	118,025
Total	$ 305,196	$ 306,374

Note 5 – Loans

The Company grants loans primarily to customers throughout North Central Pennsylvania and Southern New York. Although the Company had a diversified loan portfolio at June 30, 2013 and December 31, 2012, a substantial portion of its debtors' ability to honor their contracts is dependent on the economic conditions within these regions. The following table summarizes the primary segments of the loan portfolio and how those segments are analyzed within the allowance for loan losses as of June 30, 2013 and December 31, 2012 (in thousands):

June 30, 2013	Total Loans	Individually evaluated for impairment	Collectively evaluated for impairment
Real estate loans:			
Residential	$ 180,782	$ 487	$ 180,295
Commercial and agricultural	198,127	8,332	189,795
Construction	13,455	-	13,455
Consumer	10,062	-	10,062

Other commercial and agricultural loans	54,073	1,774	52,299
State and political subdivision loans	59,237	-	59,237
Total	515,736 $	10,593 $	505,143
Allowance for loan losses	6,989		
Net loans	$ 508,747		

December 31, 2012	Total Loans	Individually evaluated for impairment	Collectively evaluated for impairment
Real estate loans:			
Residential	$ 178,080	$ 424	$ 177,656
Commercial and agricultural	194,725	9,093	185,632
Construction	12,011	-	12,011
Consumer	10,559	-	10,559
Other commercial and agricultural loans	47,880	901	46,979
State and political subdivision loans	59,208	-	59,208
Total	502,463	$ 10,418	$ 492,045
Allowance for loan losses	6,784		
Net loans	$ 495,679		

The segments of the Bank's loan portfolio are disaggregated into classes to a level that allows management to monitor risk and performance. Residential real estate mortgages consists primarily of 15 to 30 year first mortgages on residential real estate, while residential real estate home equity loans are consumer purpose installment loans or lines of credit secured by a mortgage which is often a second lien on residential real estate with terms of 15 years or less. Commercial real estate loans are business purpose loans secured by a mortgage on commercial real estate. Agricultural real estate loans are loans secured by a mortgage on real estate used in agriculture production. Construction real estate loans are loans secured by residential or commercial real estate used during the construction phase of residential and commercial projects. Consumer loans are typically unsecured or primarily secured by something other than real estate and overdraft lines of credit connected with customer deposit accounts. Other commercial loans are loans for commercial purposes primarily secured by non-real estate collateral. Other agricultural loans are loans for agricultural purposes primarily secured by non-real estate collateral. State and political subdivisions are loans for state and local municipalities for capital and operating expenses or tax free loans used to finance commercial development.

Management considers commercial loans, other agricultural loans, commercial real estate loans and agricultural real estate loans which are 90 days or more past due to be impaired. Management will also consider a loan impaired based on other factors it becomes aware of, including the customer's results of operations and cash flows or if the loan is modified in a troubled debt restructuring. In addition, certain residential mortgages, home equity and consumer loans that are cross collateralized with commercial relationships that are determined to be impaired may also be classified as impaired. Impaired loans are analyzed to determine if it is probable that all amounts will not be collected according to the contractual terms of the loan agreement. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized through an allocation of the allowance for loan losses or a charge-off to the allowance for loan losses.

The following table includes the recorded investment and unpaid principal balances for impaired financing receivables by class, with the associated allowance amount, if applicable (in thousands):

June 30, 2013	Unpaid Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
Real estate loans:					
Mortgages	$ 376	$ 144	$ 207	$ 351	$ 24
Home Equity	136	-	136	136	13
Commercial	10,023	5,704	2,628	8,332	499
Agricultural	-	-	-	-	-
Construction	-	-	-	-	-
Consumer	-	-	-	-	-
Other commercial loans	1,828	1,466	308	1,774	1
Other agricultural loans	-	-	-	-	-
State and political subdivision loans	-	-	-	-	-
Total	$ 12,363	$ 7,314	$ 3,279	$ 10,593	$ 537
December 31, 2012					
Real estate loans:					
Mortgages	$ 309	$ 150	$ 136	$ 286	$ 8
Home Equity	138	-	138	138	14
Commercial	10,669	6,476	2,617	9,093	559
Agricultural	-	-	-	-	-
Construction	-	-	-	-	-
Consumer	-	-	-	-	-
Other commercial loans	950	592	309	901	1
Other agricultural loans	-	-	-	-	-
State and political subdivision loans	-	-	-	-	-
Total	$ 12,066	$ 7,218	$ 3,200	$ 10,418	$ 582

The following table includes the average balance of impaired financing receivables by class and the income recognized on impaired loans for the three and six month periods ended June 30, 2013 and 2012(in thousands):

	For the Six Months ended					
	June 30, 2013			June 30, 2012		
	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized Cash Basis	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized Cash Basis
Real estate loans:						
Mortgages	$ 330	$ 4	$ -	$ 83	$ 1	$ -
Home Equity	137	2	-	93	2	1
Commercial	8,595	84	35	8,138	39	23
Agricultural	-	-	-	-	-	-
Construction	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Other commercial loans	1,786	41	-	468	-	-
Other agricultural loans	-	-	-	-	-	-
State and political subdivision loans	-	-	-	-	-	-
Total	$ 10,848	$ 131	$ 35	$ 8,782	$ 42	$ 24

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	For the Three Months Ended					
	June 30, 2013			June 30, 2012		
	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized Cash Basis	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized Cash Basis
Real estate loans:						
Mortgages	$ 352	$ 2	$ -	$ 165	$ 1	$ -
Home Equity	136	1	-	93	1	-
Commercial	8,406	39	21	8,049	21	5
Agricultural	-	-	-	-	-	-
Construction	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Other commercial loans	1,916	22	-	457	-	-
Other agricultural loans	-	-	-	-	-	-
State and political subdivision loans	-	-	-	-	-	-
Total	$ 10,810	$ 64	$ 21	$ 8,764	$ 23	$ 5

Credit Quality Information

For commercial real estate, agricultural real estate, construction, other commercial, other agricultural and state and political subdivision loans, management uses a nine point internal risk rating system to monitor the credit quality. The first five categories are considered not criticized and are aggregated as “Pass” rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The definitions of each rating are defined below:

- Pass (Grades 1-5) – These loans are to customers with credit quality ranging from an acceptable to very high quality and are protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral.

- Special Mention (Grade 6) – This loan grade is in accordance with regulatory guidance and includes loans where a potential weakness or risk exists, which could cause a more serious problem if not corrected.

- Substandard (Grade 7) – This loan grade is in accordance with regulatory guidance and includes loans that have a well-defined weakness based on objective evidence and be characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

-

Doubtful (Grade 8) – This loan grade is in accordance with regulatory guidance and includes loans that have all the weaknesses inherent in a substandard asset. In addition, these weaknesses make collection or liquidation in full highly questionable and improbable, based on existing circumstances.

- Loss (Grade 9) – This loan grade is in accordance with regulatory guidance and includes loans that are considered uncollectible, or of such value that continuance as an asset is not warranted.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay loan as agreed, the Bank's loan rating process includes several layers of internal and external oversight. The Company's loan officers are responsible for the timely and accurate risk rating of the loans in each of their portfolios at origination and on an ongoing basis under the supervision of management. All commercial and agricultural loans are reviewed annually to ensure the appropriateness of the loan grade. In addition, the Bank engages an external consultant on at least an annual basis. The external consultant is engaged to 1) review a minimum of 55% (60% during 2012) of the dollar volume of the commercial loan portfolio on an annual basis, 2) review new loans originated in the last year, 3) review all relationships in aggregate over $500,000, 4) review all aggregate loan relationships over $100,000 which are over 90 days past due or classified Special Mention, Substandard, Doubtful, or Loss, and 5) such other loans which management or the consultant deems appropriate.

The following tables represent credit exposures by internally assigned grades as of June 30, 2013 and December 31, 2012 (in thousands):

June 30, 2013	Pass	Special Mention	Substandard	Doubtful	Loss	Ending Balance
Real estate loans:						
Commercial	$ 152,901	$ 6,141	$ 19,227	$ 211	$ -	$ 178,480
Agricultural	15,042	2,713	1,892	-	-	19,647
Construction	13,455	-	-	-	-	13,455
Other commercial loans	41,744	601	2,304	9	-	44,658
Other agricultural loans	7,205	935	1,275	-	-	9,415
State and political subdivision loans	59,237	-	-	-	-	59,237
Total	$ 289,584	$ 10,390	$ 24,698	$ 220	$ -	$ 324,892

December 31, 2012	Pass	Special Mention	Substandard	Doubtful	Loss	Ending Balance
Real estate loans:						
Commercial	$ 149,892	$ 7,616	$ 19,127	$ 75	$ -	$ 176,710
Agricultural	13,690	2,386	1,939	-	-	18,015
Construction	12,011	-	-	-	-	12,011
Other commercial loans	39,239	826	1,555	-	-	41,620
Other agricultural loans	4,833	589	838	-	-	6,260
State and political subdivision loans	58,120	-	1,088	-	-	59,208
Total	$ 277,785	$ 11,417	$ 24,547	$ 75	$ -	$ 313,824

For residential real estate mortgages, home equity and consumer loans, credit quality is monitored based on whether the loan is performing or non-performing, which is typically based on the aging status of the loan and payment activity, unless a specific action, such as bankruptcy, repossession, death or significant delay in payment occurs to raise awareness of a possible credit event. Non-performing loans include those loans that are considered nonaccrual, described in more detail below and all loans past due 90 or more days. The following table presents the recorded investment in those loan classes based on payment activity as of June 30, 2013 and December 31, 2012 (in thousands):

June 30, 2013	Performing	Non-performing	Total

Real estate loans:			
Mortgages	$ 111,395	$ 545	$ 111,940
Home Equity	68,677	165	68,842
Consumer	10,062	-	10,062
Total	$ 190,134	$ 710	$ 190,844

December 31, 2012	Performing	Non-performing	Total
Real estate loans:			
Mortgages	$ 105,822	$ 726	$ 106,548
Home Equity	71,263	269	71,532
Consumer	10,555	4	10,559
Total	$ 187,640	$ 999	$ 188,639

Age Analysis of Past Due Financing Receivables

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following table includes an aging analysis of the recorded investment of past due financing receivables as of June 30, 2013 and December 31, 2012 (in thousands):

June 30, 2013	30-59 Days Past Due	60-89 Days Past Due	90 Days Or Greater	Total Past Due	Current	Total Financing Receivables	90 Days and Accruing
Real estate loans:							
Mortgages	$ 443	$ 214	$ 450	$ 1,107	$ 110,833	$ 111,940	$ 63
Home Equity	389	117	140	646	68,196	68,842	38
Commercial	158	-	2,496	2,654	175,826	178,480	137
Agricultural	-	-	-	-	19,647	19,647	-
Construction	-	-	-	-	13,455	13,455	-
Consumer	58	1	-	59	10,003	10,062	-
Other commercial loans	864	1	323	1,188	43,470	44,658	15
Other agricultural loans	49	-	-	49	9,366	9,415	-
State and political subdivision loans	-	-	-	-	59,237	59,237	-
Total	$ 1,961	$ 333	$ 3,409	$ 5,703	$ 510,033	$ 515,736	$ 253
Loans considered non-accrual	$ 108	$ -	$ 3,156	$ 3,264	$ 4,942	$ 8,206	
Loans still accruing	1,853	333	253	2,439	505,091	507,530	
Total	$ 1,961	$ 333	$ 3,409	$ 5,703	$ 510,033	$ 515,736	

December 31, 2012	30-59 Days Past Due	60-89 Days Past Due	90 Days Or Greater	Total Past Due	Current	Total Financing Receivables	90 Days and Accruing
Real estate loans:							
Mortgages	$ 636	$ 294	$ 493	$ 1,423	$ 105,125	$ 106,548	$ 244
Home Equity	267	17	222	506	71,026	71,532	88
Commercial	602	-	2,149	2,751	173,959	176,710	152
Agricultural	54	-	-	54	17,961	18,015	-
Construction	-	-	-	-	12,011	12,011	-
Consumer	45	43	4	92	10,467	10,559	4
Other commercial loans	962	-	317	1,279	40,341	41,620	18
Other agricultural loans	-	-	-	-	6,260	6,260	-
State and political subdivision loans	-	-	-	-	59,208	59,208	-
Total	$ 2,566	$ 354	$ 3,185	$ 6,105	$ 496,358	$ 502,463	$ 506
Loans considered non-accrual	$ 73	$ 69	$ 2,679	$ 2,821	$ 5,246	$ 8,067	
Loans still accruing	2,493	285	506	3,284	491,112	494,396	
Total	$ 2,566	$ 354	$ 3,185	$ 6,105	$ 496,358	$ 502,463	

Nonaccrual Loans

Loans are considered for non-accrual status upon reaching 90 days delinquency, although the Company may be receiving partial payments of interest and partial repayments of principal on such loans or if full payment of principal and interest is not expected. Additionally, if management is made aware of other information including bankruptcy, repossession, death, or legal proceedings, the loan may be placed on non-accrual status. If a loan is 90 days or more past due and is well secured and in the process of collection, it may still be considered accruing.

The following table reflects the financing receivables on non-accrual status as of June 30, 2013 and December 31, 2012, respectively. The balances are presented by class of financing receivable (in thousands):

	June 30, 2013	December 31, 2012
Real estate loans:		
Mortgages	$ 482	$ 482
Home Equity	127	181
Commercial	7,241	7,042
Agricultural	-	-
Construction	-	-
Consumer	-	-
Other commercial loans	356	362
Other agricultural loans	-	-
State and political subdivision	-	-
	$ 8,206	$ 8,067

Troubled Debt Restructurings

In situations where, for economic or legal reasons related to a borrower's financial difficulties, management may grant a concession for other than an insignificant period of time to the borrower that would not otherwise be considered, the related loan is classified as a Troubled Debt Restructuring (TDR). Management strives to identify borrowers in financial difficulty early and work with them to modify more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, management measures any impairment on the restructuring by calculating the present value of the revised loan terms and comparing this balance to the Company’s investment in the loan prior to the restructuring. As these loans are individually evaluated, they are excluded from pooled portfolios when calculating the allowance for loan and lease losses and a separate allocation within the allowance for loan and lease losses is provided. Management continually evaluates loans that are considered TDRs, including payment history under the modified loan terms, the borrower’s ability to continue to repay the loan based on continued evaluation of their operating results and cash flows from operations. Based on this evaluation management would no longer consider a loan to be a TDR when the relevant facts support such a conclusion.

There were no loan modifications that were considered TDRs during the three months ended June 30, 2013. Loan modifications that are considered TDRs completed during the six months ended June 30, 2013 and 2012 and the three months ended June 30, 2012, were as follows (dollars in thousands):

	For the Six Months Ended June 30, 2013		
	Number of contracts	Pre-modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment

	Interest Modification	Term Modification	Interest Modification	Term Modification	Interest Modification	Term Modification
Real estate loans:						
Mortgages	1	-	$ 72	$ -	$ 72	$ -
Commercial	-	2	-	1,365	-	1,365
Other commercial loans	-	2	-	1,530	-	1,530
Total	1	4	$ 72	$ 2,895	$ 72	$ 2,895

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For the Three Months Ended June 30, 2012

	Number of contracts		Pre-modification Outstanding Recorded Investment		Post-Modification Outstanding Recorded Investment	
	Interest Modification	Term Modification	Interest Modification	Term Modification	Interest Modification	Term Modification
Real estate loans:						
Mortgages	1	1	$ 48	$ 71	$ 48	$ 71
Total	1	1	$ 48	$ 71	$ 48	$ 71

For the Six Months Ended June 30, 2012

	Number of contracts		Pre-modification Outstanding Recorded Investment		Post-Modification Outstanding Recorded Investment	
	Interest Modification	Term Modification	Interest Modification	Term Modification	Interest Modification	Term Modification
Real estate loans:						
Mortgages	1	1	$ 48	$ 71	$ 48	$ 71
Commercial	-	2	-	98	-	98
Total	1	3	$ 48	$ 169	$ 48	$ 169

Recidivism, or the borrower defaulting on its obligation pursuant to a modified loan, results in the loan once again becoming a non-accrual loan. Recidivism occurs at a notably higher rate than do defaults on new origination loans, so modified loans present a higher risk of loss than do new origination loans. The following table presents the recorded investment in loans that were modified as TDRs during each 12-month period prior to the current reporting periods, which begin January 1, 2013 and 2012 (six month periods) and April 1, 2013 and 2012 (3 month periods), respectively, and that subsequently defaulted during these reporting periods (dollars in thousands):

	For the Three Months Ended				For the Six Months Ended			
	June 30, 2013		June 30, 2012		June 30, 2013		June 30, 2012	
	Number of contracts	Recorded investment	Number of contracts	Recorded investment	Number of contracts	Recorded investment	Number of contracts	Recorded investment
Real estate loans:								
Commercial	1	$ 535	-	$ -	-	$ -	1	$ 48
Total recidivism	1	$ 535	-	$ -	-	$ -	1	$ 48

Allowance for Loan Losses

The following table segregates the allowance for loan losses (ALLL) into the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of June 30, 2013 and December 31, 2012, respectively (in thousands):

	June 30, 2013	December 31, 2012

	Individually evaluated for impairment	Collectively evaluated for impairment	Total	Individually evaluated for impairment	Collectively evaluated for impairment	Total
Real estate loans:						
Residential	$ 38	$ 896	$ 934	$ 22	$ 853	$ 875
Commercial and agricultural	499	3,741	4,240	559	3,878	4,437
Construction	-	91	91	-	38	38
Consumer	-	114	114	-	119	119
Other commercial and agricultural loans	-	957	957	1	727	728
State and political subdivision loans	-	310	310	-	271	271
Unallocated	-	343	343	-	316	316
Total	$ 537	$ 6,452	$ 6,989	$ 582	$ 6,202	$ 6,784

The following tables roll forward the balance of the ALLL by portfolio segment for the three and six month periods ended June 30, 2013 and 2012, respectively (in thousands):

	Balance at March 31, 2013	Charge-offs	Recoveries	Provision	Balance at June 30, 2013
Real estate loans:					
Residential	$ 913	$ (13)	$ -	$ 34	$ 934
Commercial and agricultural	4,416	-	-	(176)	4,240
Construction	78	-	-	13	91
Consumer	118	(10)	9	(3)	114
Other commercial and agricultural loans	700	-	-	257	957
State and political				-	
subdivision loans	303	-	-	7	310
Unallocated	400	-	-	(57)	343
Total	$ 6,928	$ (23)	$ 9	$ 75	$ 6,989

	Balance at December 31, 2012	Charge-offs	Recoveries	Provision	Balance at June 30, 2013
Real estate loans:					
Residential	$ 875	$ (13)	$ 2	$ 70	$ 934
Commercial and agricultural	4,437	-	-	(197)	4,240
Construction	38	-	-	53	91
Consumer	119	(30)	21	4	114
Other commercial and agricultural loans	728	-	-	229	957
State and political				-	
subdivision loans	271	-	-	39	310
Unallocated	316	-	-	27	343
Total	$ 6,784	$ (43)	$ 23	$ 225	$ 6,989

	Balance at March 31, 2012	Charge-offs	Recoveries	Provision	Balance at June 30, 2012
Real estate loans:					
Residential	$ 753	$ -	$ -	$ 33	$ 786
Commercial and agricultural	4,336	-	6	63	4,405
Construction	16	-	-	3	19
Consumer	96	(16)	7	21	108
Other commercial and agricultural loans	671	-	3	11	685
State and political				-	
subdivision loans	245	-	-	1	246

Unallocated	428	-	-	(27)	401
Total	$ 6,545	$ (16)	$ 16	$ 105	$ 6,650

	Balance at December 31, 2011	Charge-offs	Recoveries	Provision	Balance at June 30, 2012
Real estate loans:					
Residential	$ 805	$ (49)	$ -	$ 30	$ 786
Commercial and agricultural	4,132	(2)	6	269	4,405
Construction	15	-	-	4	19
Consumer	111	(24)	16	5	108
Other commercial and agricultural loans	674	-	6	5	685
State and political				-	
subdivision loans	235	-	-	11	246
Unallocated	515	-	-	(114)	401
Total	$ 6,487	$ (75)	$ 28	$ 210	$ 6,650

The Company allocates the ALLL based on the factors described below, which conform to the Company's loan classification policy and credit quality measurements. In reviewing risk within the Bank's loan portfolio, management has determined there to be several different risk categories within the loan portfolio. The ALLL consists of amounts applicable to: (i) residential real estate loans; (ii) residential real estate home equity loans; (iii) commercial real estate loans; (iv) agricultural real estate loans; (v) real estate construction loans; (vi) commercial and other loans; (vii) consumer loans; (viii) other agricultural loans and (ix) state and political subdivision loans. Factors considered in this process include general loan terms, collateral, and availability of historical data to support the analysis. Historical loss percentages are calculated and used as the basis for calculating allowance allocations. Certain qualitative factors are evaluated to determine additional inherent risks in the loan portfolio, which are not necessarily reflected in the historical loss percentages. These factors are then added to the historical allocation percentage to get the adjusted factor to be applied to non-classified loans. The following qualitative factors are analyzed:

- Level of and trends in delinquencies, impaired/classified loans
  - § Change in volume and severity of past due loans
  - § Volume of non-accrual loans
  - § Volume and severity of classified, adversely or graded loans;
- Level of and trends in charge-offs and recoveries;
- Trends in volume, terms and nature of the loan portfolio;
- Effects of any changes in risk selection and underwriting standards and any other changes in lending and recovery policies, procedures and practices;
- Changes in the quality of the Bank's loan review system;
- Experience, ability and depth of lending management and other relevant staff;
- National, state, regional and local economic trends and business conditions
  - § General economic conditions
  - § Unemployment rates
  - § Inflation / Consumer Price Index
  - § Changes in values of underlying collateral for collateral-dependent loans;
- Industry conditions including the effects of external factors such as competition, legal, and regulatory requirements on the level of estimated credit losses; and
- Existence and effect of any credit concentrations, and changes in the level of such concentrations.

The Company also maintains an unallocated allowance to account for any factors or conditions that may cause a potential loss but are not specifically addressed in the process described above. The Company analyzes its loan portfolio each quarter to determine the appropriateness of its allowance for loan losses.

Loans determined to be TDRs are impaired and for purposes of estimating the ALLL must be individually evaluated for impairment. In calculating the impairment, the Company calculates the present value utilizing an analysis of discounted cash flows. If the present value calculated is below the recorded investment of the loan, impairment is recognized by a charge to the provision for loan and lease losses and a credit to the ALLL.

We continually review the model utilized in calculating the required allowance. The following qualitative factors experienced changes during the first six months of 2013:

- The qualitative factor for national, state, regional and local economic trends and business conditions was increased for all loan categories due to rising unemployment rates in the local economy as a result of the slowdown in Marcellus shale natural gas exploration activities.
- The qualitative factor for trends in volume, terms and nature of the loan portfolio was increased for commercial and agricultural real estate, other commercial and agricultural loans and state and political subdivision loan categories due to the increase of the number of loans that are participations that were purchased from other banks and therefore subject to different underwriting standards.

- The qualitative factor for the existence and effect of any credit concentrations and changes in the level of such concentrations was increased for commercial and other loans and was lowered for commercial and agricultural real estate as the loan growth has slowed in 2013.

The following qualitative factors experienced changes during the three months ended June 30, 2013:

- The qualitative factor for trends in volume, terms and nature of the loan portfolio was increased for commercial and agricultural real estate, other commercial and agricultural loans and state and political subdivision loan categories due to the increase of the number of loans that are participations that were purchased from other banks and therefore subject to different underwriting standards.
- The qualitative factor for the existence and effect of any credit concentrations and changes in the level of such concentrations was increased for commercial and other loans and was lowered for commercial and agricultural real estate as the loan growth has slowed in 2013.

The following factors experienced changes during the first six months of 2012:

- The qualitative factor for changes in values of underlying collateral was decreased for residential and commercial real estate loans due to the serious flooding experienced in our primary market in the third quarter of 2011 not being as severe as originally expected.
- The qualitative factors for changes in levels of and trends in delinquencies, impaired/classified loans were increased for commercial real estate due to the increase in the Company's internal watch list for commercial real estate loans since December 31, 2011.
- The qualitative factors for changes in industry conditions were increased for agricultural real estate and other agricultural loans due to decreases in milk prices from December 31, 2011 to June 30, 2012.

During the second quarter of 2012, there were no significant changes in any qualitative factor. As a result, the change in the allocation of the allowance from March 31, 2012, is mainly attributable to the changes in the loan portfolio balances since that date.

Note 6 – Federal Home Loan Bank Stock

The Bank is a member of the FHLB of Pittsburgh and as such, is required to maintain a minimum investment in stock of the FHLB that varies with the level of advances outstanding with the FHLB. As of June 30, 2013 and December 31, 2012, the Bank holds $2,984,200 and $3,290,000, respectively. The stock is bought from and sold to the FHLB based upon its $100 par value. The stock does not have a readily determinable fair value and as such is classified as restricted stock, carried at cost and evaluated by management. The stock's value is determined by the ultimate recoverability of the par value rather than by recognizing temporary declines. The determination of whether the par value will ultimately be recovered is influenced by criteria such as the following: (a) A significant decline in net assets of the FHLB as compared to the capital stock amount and the length of time this situation has persisted (b) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance (c) the impact of legislative and regulatory changes on the customer base of the FHLB and (d) the liquidity position of the FHLB. Management evaluated the stock and concluded that the stock was not impaired for the periods presented herein. Management considered that the FHLB's regulatory capital ratios have improved in the most recent quarters, liquidity appears adequate, new shares of FHLB stock continue to exchange hands at the $100 par value and the FHLB has repurchased shares of excess capital stock from its members during 2012 and 2013 and has reinstituted the dividend.

Note 7 - Employee Benefit Plans

For additional detailed disclosure on the Company's pension and employee benefits plans, please refer to Note 11 of the Company's Consolidated Financial Statements included in the 2012 Annual Report on Form 10-K.

Noncontributory Defined Benefit Pension Plan

The Bank sponsors a noncontributory defined benefit pension plan ("Pension Plan") covering substantially all employees and officers. The Bank's funding policy is to make annual contributions, if needed, based upon the funding formula developed by the plan's actuary. Any employee with a hire date of January 1, 2007 or later is not eligible to participate in the Pension Plan. In lieu of the Pension Plan, employees with a hire date of January 1, 2007 or later are eligible to receive, after meeting certain length of service requirements, an annual discretionary 401(k) plan contribution from the Bank equal to a percentage of an employee's base compensation. The contribution amount, if any, is placed in a separate account within the 401(k) plan and is subject to a vesting requirement.

For employees who are eligible to participate in the Pension Plan, the Pension Plan requires benefits to be paid to eligible employees based primarily upon age and compensation rates during employment. Upon retirement or other termination of employment, employees can elect either an annuity benefit or a lump sum distribution of vested benefits in the Pension Plan.

The following sets forth the components of net periodic benefit costs of the Pension Plan for the three and six months ended June 30, 2013 and 2012, respectively (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Service cost	$ 76	$ 54	$ 177	$ 167
Interest cost	79	35	185	174
Expected return on plan assets	(169)	(80)	(343)	(286)
Net amortization and deferral	86	52	128	68
Net periodic benefit cost	$ 72	$ 61	$ 147	$ 123

The Company expects to contribute $1,000,000 to the Pension Plan in 2013.

Defined Contribution Plan

The Company sponsors a voluntary 401(k) savings plan which eligible employees can elect to contribute up to the maximum amount allowable not to exceed the limits of IRS Code Sections 401(k). Under the plan, the Company also makes required contributions on behalf of the eligible employees. The Company’s contributions vest immediately. Contributions by the Company totaled $147,000 and $132,000 for the six months ended June 30, 2013 and 2012, respectively. For the three months ended June 30, 2013 and 2012, contributions by the Company totaled $92,000 and $80,000, respectively.

Directors’ Deferred Compensation Plan

The Company’s directors may elect to defer all or portions of their fees until their retirement or termination from service. Amounts deferred under the plan earn interest based upon the highest current rate offered to certificate of deposit customers. Amounts deferred under the plan are not guaranteed and represent a general liability of the Company. At June 30, 2013 and December 31, 2012, an obligation of $971,000 and $1,001,000, respectively, was included in other liabilities for this plan in the consolidated balance sheet. Amounts included in interest expense on the deferred amounts totaled $3,000 and $4,000 for each of the three months ended June 30, 2013 and 2012. For the six months ended June 30, 2013 and 2012, amounts included in interest expense on the deferred amounts totaled $7,000 and $8,000, respectively.

Restricted Stock Plan

The Company maintains a Restricted Stock Plan (the “Plan”) whereby employees and non-employee corporate directors are eligible to receive awards of restricted stock based upon performance related requirements. Awards granted under the Plan are in the form of the Company’s common stock and are subject to certain vesting requirements including continuous employment or service with the Company. A total of 100,000 shares of the Company’s common stock have been authorized under the Plan. As of June 30, 2013, 67,756 shares remain available to be issued under the Plan. The Plan assists the Company in attracting, retaining and motivating employees to make substantial contributions to the success of the Company and to increase the emphasis on the use of equity as a key component of compensation.

The following table details the vesting, awarding and forfeiting of restricted shares during 2013 and 2012:

	Three months ended June 30,				Six months ended June 30,			
	2013		2012		2013		2012	
	Unvested Shares	Weighted Average Market Price	Unvested Shares	Weighted Average Market Price	Unvested Shares	Weighted Average Market Price	Unvested Shares	Weighted Average Market Price
Outstanding, beginning of period	7,269	$ 35.16	6,280	$ 28.15	8,646	$ 35.51	9,921	$ 29.37
Granted	3,027	48.21	3,808	37.10	3,027	48.21	3,808	37.10
Forfeited	-	-	-	-	(55)	37.10	-	-
Vested	(2,830)	31.35	(1,581)	26.80	(4,152)	33.26	(5,222)	25.59
Outstanding, end of period	7,466	$ 41.89	8,507	$ 35.16	7,466	$ 41.89	8,507	$ 35.16

Compensation cost related to restricted stock is recognized based on the market price of the stock at the grant date over the vesting period. Compensation expense related to restricted stock was $77,000 and $66,000 for the six months ended June 30, 2013 and 2012, respectively. For the three months ended June 30, 2013 and 2012, compensation expense totaled $39,000 and $33,000, respectively.

Supplemental Executive Retirement Plan

The Company maintains a non-qualified supplemental executive retirement plan ("SERP") for certain executives to compensate those executive participants in the Company's noncontributory defined benefit pension plan whose benefits are limited by compensation limitations under current tax law. At June 30, 2013 and December 31, 2012, an obligation of $973,000 and $901,000, respectively, was included in other liabilities for this plan in the consolidated balance sheet. Expenses related to this plan totaled $72,000 and $47,000 for the six months ended June 30, 2013 and 2012, respectively. For the three months ended June 30, 2013 and 2012, expenses totaled $36,000 and $24,000, respectively.

Note 8 – Accumulated Comprehensive Income

The following tables present the changes in accumulated other comprehensive income (loss) by component net of tax for the three and six months ended June 30, 2013:

	Three months ended June 30, 2013			
	Unrealized gain (loss) on available for sale securities (a)	Unrealized gain (loss) on interest rate swap (a)	Defined Benefit Pension Items (a)	Total
Balance as of March 31, 2013	$ 5,717	$ (99)	$ (1,991)	$ 3,627
Other comprehensive income (loss) before reclassifications (net of tax)	(4,393)	34	-	(4,359)

Amounts reclassified from accumulated other comprehensive income (loss) (net of tax)	(65)	-	84	19
Net current period other comprehensive income (loss)	(4,458)	34	84	(4,340)
Balance as of June 30, 2013	$ 1,259	$ (65)	$ (1,907)	$ (713)

	Six months ended June 30, 2013			
	Unrealized gain (loss) on available for sale securities (a)	Unrealized gain (loss) on interest rate swap (a)	Defined Benefit Pension Items (a)	Total
Balance as of December 31, 2012	$ 6,754	$ (132)	$ (1,991)	$ 4,631
Other comprehensive income (loss) before reclassifications (net of tax)	(5,301)	67	-	(5,234)
Amounts reclassified from accumulated other comprehensive income (loss) (net of tax)	(194)	-	84	(110)
Net current period other comprehensive income (loss)	(5,495)	67	84	(5,344)
Balance as of June 30, 2013	$ 1,259	$ (65)	$ (1,907)	$ (713)

(a) Amounts in parentheses indicate debits

The following table presents the significant amounts reclassified out of each component of accumulated other comprehensive income for the three and six months ended June 30, 2013:

Details about accumulated other comprehensive income (loss)	Amount reclassified from accumulated comprehensive income (loss) (a)		Affected line item in the statement where net Income is presented
	Three Months Ended	Six Months Ended	
	June 30, 2013		
Unrealized gains and losses on available for sale securities			
	$ 98	$ 294	Investment securities gains, net
	(33)	(100)	Provision for income taxes
	$ 65	$ 194	Net of tax
Defined benefit pension items			
	$ (128)	$ (128)	Salaries and employee benefits
	44	44	Provision for income taxes
	$ (84)	$ (84)	Net of tax

(a) Amounts in parentheses indicate debits to profit/loss

Note 9 – Fair Value Measurements

The Company established a hierarchal disclosure framework associated with the level of pricing observability utilized in measuring assets and liabilities at fair value. The three broad levels defined by this hierarchy 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 quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities include 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.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality, the Company's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. Our valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Company’s valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally coincides with the Company’s monthly and/or quarterly valuation process.

Financial Instruments Recorded at Fair Value on a Recurring Basis

The fair values of securities available for sale are determined by quoted prices in active markets, when available, and classified as Level I. If quoted market prices are not available, the fair value is determined by a matrix pricing, which is a mathematical technique, widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities and classified as Level II. The fair values consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. In cases where significant credit valuation adjustments are incorporated into the estimation of fair value, reported amounts are classified as Level III inputs.

Currently, we use an interest rate swap, which is a derivative, to manage our interest rate risk related to the trust preferred security. The valuation of this instrument is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative and classified as Level II. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including LIBOR rate curves. We also obtain dealer quotations for these derivatives for comparative purposes to assess the reasonableness of the model valuations.

The following tables present the assets and liabilities reported on the consolidated balance sheet at their fair value on a recurring basis as of June 30, 2013 and December 31, 2012 by level within the fair value hierarchy (in thousands). 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			
	Level I	Level II	Level III	Total
Fair value measurements on a recurring basis:				
Assets				
Securities available for sale:				
U.S. Agency securities	$ -	$ 137,880	$ -	$ 137,880
U.S. Treasury securities		11,471		11,471
Obligations of state and political subdivisions	-	95,177	-	95,177
Corporate obligations	-	20,966	-	20,966
Mortgage-backed securities in government sponsored entities	-	40,880	-	40,880
Equity securities in financial institutions	1,561	-	-	1,561
Liabilities				
	-	(99)	-	(99)

Trust Preferred
Interest Rate Swap

	December 31, 2012			
	Level I	Level II	Level III	Total
Fair value measurements on a recurring basis:				
Assets				
Securities available for sale:				
U.S. Agency securities	$ -	$ 127,234	$ -	$ 127,234
U.S. Treasury securities	-	4,947	-	4,947
Obligations of state and political subdivisions	-	100,875	-	100,875
Corporate obligations	-	22,109	-	22,109
Mortgage-backed securities in government sponsored entities	-	53,673	-	53,673
Equity securities in financial institutions	1,414	-	-	1,414
Liabilities				
Trust Preferred Interest Rate Swap	-	(200)	-	(200)

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Financial Instruments, Non-Financial Assets and Non-Financial Liabilities Recorded at Fair Value on a Nonrecurring Basis

The Company may be required, from time to time, to measure certain financial assets, financial liabilities, non-financial assets and non-financial liabilities at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets that are measured at the lower of cost or market value that were recognized at fair value below cost at the end of the period. Certain non-financial assets measured at fair value on a non-recurring basis include foreclosed assets (upon initial recognition or subsequent impairment), non-financial assets and non-financial liabilities measured at fair value in the second step of a goodwill impairment test, and intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment. Non-financial assets measured at fair value on a non-recurring basis during 2013 and 2012 include certain foreclosed assets which, upon initial recognition, were remeasured and reported at fair value through a charge-off to the allowance for possible loan losses and certain foreclosed assets which, subsequent to their initial recognition, were remeasured at fair value through a write-down included in other non-interest expense.

- Impaired Loans - Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment using one of several methods, including collateral value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. Collateral values are estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria. For a majority of impaired real estate related loans, the Company obtains a current external appraisal. Other valuation techniques are used as well, including internal valuations, comparable property analysis and contractual sales information.
- Other Real Estate owned – Other real estate owned, which is obtained through the Bank's foreclosure process is valued utilizing the appraised collateral value. Collateral values are estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria. At the time the foreclosure is completed, the Company obtains an updated external appraisal.

Assets measured at fair value on a nonrecurring basis as of June 30, 2013 and December 31, 2012 are included in the table below (in thousands):

	June 30, 2013			
	Level 1	Level II	Level III	Total
Impaired Loans	$ -	$ -	$ 10,056	$ 10,056
Other real estate owned	-	-	670	670

	December 31, 2012			
	Level 1	Level II	Level III	Total
Impaired Loans	$ -	$ -	$ 9,836	$ 9,836
Other real estate owned	-	-	616	616

The following table provides a listing of the significant unobservable inputs used in the fair value measurement process for items valued utilizing level III techniques.

	Fair value as of June 30, 2013	Fair value as of December 31, 2012	Valuation Technique(s)	Unobservable input	Range
Impaired Loans	$ 4,610	$ 4,882	Discounted Cash Flows	Change in discount rates	0-7%
	5,446	4,954	Appraised Collateral Values	Discount for time since appraisal	0-20%
				Selling costs	0%-10%
				Holding period	0 - 18 months
Other real estate owned	670	616	Appraised Collateral Values	Discount for time since appraisal	0-20%
				Selling costs	0%-10%
				Holding period	0 - 18 months

The fair values of the Company's financial instruments are as follows (in thousands):

June 30, 2013	Carrying Amount	Fair Value	Level I	Level II	Level III
Financial assets:					
Cash and due from banks	$ 11,570	$ 11,570	$ 11,570	$ -	$ -
Available-for-sale securities	307,935	307,935	1,561	306,374	-
Loans held for sale	796	796	796		
Net loans	508,747	522,909	-	-	522,909
Bank owned life insurance	14,427	14,427	14,427	-	-
Regulatory stock	3,259	3,259	3,259	-	-
Accrued interest receivable	3,821	3,821	3,821	-	-
Financial liabilities:					
Deposits	$ 748,014	$ 750,811	$ 477,983	$ -	$ 272,828
Borrowed funds	33,993	30,965	-	30,965	-
Trust preferred interest rate swap	99	99	-	99	-
Accrued interest payable	964	964	964	-	-

December 31, 2012	Carrying Amount	Fair Value	Level I	Level II	Level III
Financial assets:					

Cash and due from banks	$ 26,333	$ 26,333	$ 26,333	$ -	$ -
Available-for-sale securities	310,252	310,252	1,414	308,838	-
Loans held for sale	1,458	1,458	1,458		
Net loans	495,679	522,502	-	-	522,502
Bank owned life insurance	14,177	14,177	14,177	-	-
Regulatory stock	3,565	3,565	3,565	-	-
Accrued interest receivable	3,816	3,816	3,816	-	-
Financial liabilities:					
Deposits	$ 737,096	$ 742,422	$ 462,557	$ -	$ 279,865
Borrowed funds	46,126	43,403	-	43,403	-
Trust preferred interest rate swap	200	200	-	200	-
Accrued interest payable	1,143	1,143	1,143	-	-

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

Fair values have been determined by the Company using historical data, as generally provided in the Company's regulatory reports, and an estimation methodology suitable for each category of financial instruments. The Company's fair value estimates, methods and assumptions are set forth below for the Company's other financial instruments.

Cash and Cash Equivalents:

The carrying amounts for cash and due from banks approximate fair value because they have original maturities of 90 days or less and do not present unanticipated credit concerns.

Accrued Interest Receivable and Payable:

The carrying amounts for accrued interest receivable and payable approximate fair value because they are generally received or paid in 90 days or less and do not present unanticipated credit concerns.

Available-For-Sale Securities:

The fair values of available-for-sale securities are based on quoted market prices as of the balance sheet date. For certain instruments, fair value is estimated by obtaining quotes from independent dealers.

Loans held for sale

The carrying amount for loans held for sale approximates fair value as the loans are only held for less than a week from origination.

Loans:

Fair values are estimated for portfolios of loans with similar financial characteristics. The fair value of performing loans has been estimated by discounting expected future cash flows. The discount rate used in these calculations is derived from the Treasury yield curve adjusted for credit quality, operating expense and prepayment option price, and is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. The estimate of maturity is based on the Company's historical experience with repayments for each loan classification, modified as required by an estimate of the effect of current economic and lending conditions.

Fair value for significant nonperforming loans is based on recent external appraisals. If appraisals are not available, estimated cash flows are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows, and discount rates are judgmentally determined using available market information and specific borrower information.

Bank Owned Life Insurance:

The carrying value of bank owned life insurance approximates fair value based on applicable redemption provisions.

Regulatory Stock:

The carrying value of regulatory stock approximates fair value based on applicable redemption provisions.

Deposits:

The fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings and NOW accounts, and money market accounts, is equal to the amount payable on demand. The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities.

The deposits' fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market, commonly referred to as the core deposit intangible.

Borrowed Funds:

Rates available to the Company for borrowed funds with similar terms and remaining maturities are used to estimate the fair value of borrowed funds.

Trust Preferred Interest Rate Swap:

The fair value of the trust preferred interest rate swap is based on a pricing model that utilizes a yield curve and information contained in the swap agreement.

Note 10 – Recent Accounting Pronouncements

In July, 2012, the FASB issued ASU 2012-02, Intangibles – Goodwill and Other (Topic 350) – Testing Indefinite-Lived Intangible Assets for Impairment. ASU 2012-02 give entities the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that an indefinite-lived intangible asset is impaired. If, after assessing the totality of events or circumstances, an entity determines it is more likely than not that an indefinite-lived intangible asset is impaired, then the entity must perform the quantitative impairment test. If, under the quantitative impairment test, the carrying amount of the intangible asset exceeds its fair value, an entity should recognize an impairment loss in the amount of that excess. Permitting an entity to assess qualitative factors when testing indefinite-lived intangible assets for impairment results in guidance that is similar to the goodwill impairment testing guidance in ASU 2011-08. ASU 2012-02 is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012 (early adoption permitted). This ASU is not expected to have a significant impact on the Company's financial statements.

In October, 2012, the FASB issued ASU 2012-06, Business Combinations (Topic 805) - Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution. ASU 2012-06 requires that when a reporting entity recognizes an indemnification asset (in accordance with Subtopic 805-20) as a result of a government assisted acquisition of a financial institution and subsequently a change in the cash flows expected to be collected on the indemnification asset occurs (as a result of a change in cash flows expected to be collected on the assets subject to indemnification), the reporting entity should subsequently account for the change in the measurement of the indemnification asset on the same basis as the change in the assets subject to indemnification. Any amortization of changes in value should be limited to the contractual term of the indemnification agreement (that is, the lesser of the term of the indemnification agreement and the remaining life of the indemnified assets). ASU 2012-06 is effective for fiscal years, and interim periods within those years, beginning on or after December 15, 2012. Early adoption is permitted. The amendments should be applied prospectively to any new indemnification assets acquired after the date of adoption and to indemnification assets existing as of the date of adoption arising from a government-assisted acquisition of a financial institution. This ASU is not expected to have a significant impact on the Company's financial statements.

In February 2013, the FASB issued ASU 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. The amendments in this Update require an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles (GAAP) to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. For public entities, the amendments are effective prospectively for reporting periods beginning after December 15, 2012. For nonpublic entities, the amendments are effective prospectively for reporting periods beginning after December 15, 2013. Early adoption is permitted. The expanded disclosures are presented in Note 8.

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.

ITEM 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements