SB FINANCIAL GROUP, INC.
Form 10-Q
November 13, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from ____________________to________________________________

Commission file number 0-13507

SB FINANCIAL GROUP, INC.

(Exact name of registrant as specified in its charter)

Ohio	34-1395608
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

401 Clinton Street, Defiance, Ohio 43512

(Address of principal executive offices)

(Zip Code)

(419) 783-8950

(Registrant's telephone number, including area code)

N/A

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Shares, without par value	**4,875,131 shares**
(class)	**(Outstanding at November 13, 2014)**

SB FINANCIAL GROUP, INC.

FORM 10-Q

TABLE OF CONTENTS

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

SB Financial Group, Inc.

Condensed Consolidated Balance Sheets
September 30, 2014 and December 31, 2013

($ in Thousands)	September 2014 (unaudited)	December 2013
ASSETS		
Cash and due from banks	$ 21,870	$ 13,137
Securities available for sale, at fair value	81,148	89,793
Other securities - FRB and FHLB Stock	3,748	3,748
Total investment securities	84,896	93,541
Loans held for sale	6,736	3,366
Loans, net of unearned income	505,924	477,303
Allowance for loan losses	(6,713)	(6,964)
Net loans	499,211	470,339
Premises and equipment, net	13,256	12,607
Cash surrender value of life insurance	13,074	12,906
Goodwill	16,353	16,353
Core deposits and other intangibles	338	655
Foreclosed assets held for sale, net	540	651
Mortgage servicing rights	5,720	5,180
Accrued interest receivable	1,853	1,281
Other assets	709	1,738
Total assets	$ 664,556	$ 631,754
Commitments and Contingent liabilities	-	-
LIABILITIES AND EQUITY		
Deposits		
Non interest bearing demand	$ 90,261	$ 81,570
Interest bearing demand	119,805	119,551
Savings	61,770	61,652
Money market	96,506	79,902

Time deposits	166,919	175,559
Total deposits	535,261	518,234
Notes payable	7,000	589
Advances from Federal Home Loan Bank	30,000	16,000
Repurchase agreements	17,902	14,696
Trust preferred securities	10,310	20,620
Accrued interest payable	355	639
Other liabilities	3,462	4,707
Total liabilities	604,290	575,485
Equity		
Preferred stock	-	-
Common stock	12,569	12,569
Additional paid-in capital	15,418	15,412
Retained earnings	33,075	29,899
Accumulated other comprehensive income	831	74
Treasury stock	(1,627)	(1,685)
Total equity	60,266	56,269
Total liabilities and equity	$ 664,556	$ 631,754

See notes to condensed consolidated financial statements (unaudited)

Note: The balance sheet at December 31, 2013 has been derived from the audited consolidated financial statements at that date

3

SB Financial Group, Inc.

Condensed Consolidated Statements of Income (Unaudited)

	Three Months Ended		Nine Months Ended	
($ in thousands, except share data)	September 2014	September 2013	September 2014	September 2013
Interest income				
Loans				
Taxable	$5,855	$ 5,649	$16,750	$ 17,406
Nontaxable	9	14	38	54
Securities				
Taxable	279	305	898	931
Nontaxable	178	178	532	522
Total interest income	6,321	6,146	18,218	18,913
Interest expense				
Deposits	500	539	1,501	1,718
Repurchase Agreements & Other	6	13	21	44
Federal Home Loan Bank advances	94	83	239	257
Trust preferred securities	371	336	1,034	1,077
Total interest expense	971	971	2,795	3,096
Net interest income	5,350	5,175	15,423	15,817
Provision for loan losses	150	401	300	900
Net interest income after provision for loan losses	5,200	4,774	15,123	14,917
Noninterest income				
Wealth Management Fees	670	669	1,951	1,964
Customer service fees	730	659	2,005	1,914
Gain on sale of mtg. loans & OMSR's	1,442	1,356	3,225	4,290
Mortgage loan servicing fees, net	287	408	688	1,005
Gain on sale of non-mortgage loans	71	44	178	282
Data service fees	337	333	965	1,205
Net gain on sales of securities	-	28	56	48
Gain/(loss) on sale/disposal of assets	(15)	15	(64)	(219)
Other income	287	198	659	608
Total non-interest income	3,809	3,710	9,663	11,097
Noninterest expense				
Salaries and employee benefits	3,435	3,343	10,006	10,470
Net occupancy expense	508	507	1,566	1,561
Equipment expense	616	701	1,900	2,159

Data processing fees	238	189	698	460
Professional fees	435	456	1,238	1,384
Marketing expense	105	135	398	335
Telephone and communication	94	156	313	472
Postage and delivery expense	195	199	586	623
State, local and other taxes	89	140	276	412
Employee expense	122	125	377	403
Intangible amortization expense	55	129	317	435
OREO Impairment	-	-	-	33
Other expenses	996	482	1,918	1,565
Total non-interest expense	6,888	6,562	19,593	20,312
Income before income tax expense	2,121	1,922	5,193	5,702
Income tax expense	608	578	1,455	1,721
Net income	$1,513	$ 1,344	$3,738	$ 3,981
Common share data:				
Basic earnings per common share	$0.31	$ 0.28	$0.77	$ 0.82
Diluted earnings per common share	$0.31	$ 0.28	$0.76	$ 0.82
Average shares outstanding ($ in thousands):				
Basic:	4,875	4,867	4,873	4,865
Diluted:	4,900	4,881	4,896	4,877

See notes to condensed consolidated financial statements (unaudited)

SB Financial Group, Inc.

Condensed Consolidated Statements of Comprehensive Income (unaudited)

($'s in thousands)	Three Months Ended Sep. 30, 2014	Three Months Ended Sep. 30, 2013	Nine Months Ended Sep. 30, 2014	Nine Months Ended Sep. 30, 2013
Net income	$1,513	$1,344	$3,738	$3,981
Other comprehensive (loss)/income:				
Available-for-sale investment securities:				
Gross unrealized holding (loss) gain arising in the period	(117)	(95)	1,203	(2,096)
Related tax (expense) benefit	40	33	(409)	713
Less: reclassification adjustment for loss realized in income	-	(28)	(56)	(48)
Related tax benefit	-	9	19	16
Net effect on other comprehensive (loss) income	(77)	(81)	757	(1,415)
Total comprehensive income	$1,436	$1,263	$4,495	$2,566

SB Financial Group, Inc.

Condensed Consolidated Statements of Shareholders' Equity (unaudited)

($'s in thousands except per share data)	**Preferred Stock**	**Common Stock**	**Additional Paid-in Capital**	**Retained Earnings**	**Accumulated Other Comprehensive Income (Loss)**	**Treasury Stock**	**Total**
Balance, January 1, 2014	$ -	$12,569	$15,412	$29,899	$74	$(1,685)	$56,269
Net Income				3,738			3,738
Other Comprehensive Income					757		757
Dividends on Common Stk., $0.115 per share				(562)			(562)
Restricted Stock Issuance						33	33
Stock options exercised			(41)			25	(16)
Expense of stock option plan			47				47
Balance, September 30, 2014	$ -	$12,569	$15,418	$33,075	$831	$(1,627)	$60,266
Balance, January 1, 2013	$ -	$12,569	$15,374	$25,280	$1,830	$(1,769)	$53,284
Net Income				3,981			3,981
Other Comprehensive Loss					(1,415)		(1,415)
Dividends on Common Stk., $0.085 per share				(415)			(415)

Stock options exercised			(27)			77	50
Expense of stock option plan			52				52
Balance, September 30, 2013	$ -	$ 12,569	$ 15,399	$ 28,846	$ 415	$ (1,692)	$ 55,537

See notes to condensed consolidated financial statements (unaudited)

5

SB Financial Group, Inc.

Condensed Consolidated Statements of Cash Flows (Unaudited)

	Nine Months Ended Sep. 30,	
($'s in thousands)	2014	2013
Operating Activities		
Net Income	$3,738	$3,981
Items (using)/providing cash		
Depreciation and amortization	859	813
Provision for loan losses	300	900
Expense of share-based compensation plan	47	52
Amortization of premiums and discounts on securities	721	755
Amortization of intangible assets	317	435
Amortization of originated mortgage servicing rights	439	699
Recapture of originated mortgage servicing rights impairment	(62)	(649)
Proceeds from sale of loans held for sale	171,993	221,444
Originations of loans held for sale	(167,667)	(209,104)
Impairment of mortgage servicing rights	101	-
Gain from sale of loans	(3,403)	(4,572)
Gain on sales of available for sale securities	(56)	(48)
Loss on sale of assets	64	121
OREO impairment	-	33
Changes in		
Interest receivable	(572)	(459)
Other assets	(5,414)	(3,694)
Income from bank owned life insurance	(168)	(249)
Interest payable and other liabilities	(624)	(98)
Net cash provided by operating activities	613	10,360
Investing Activities		
Purchases of available-for-sale securities	(9,685)	(21,494)
Proceeds from maturities of available-for-sale securities	14,457	23,278
Proceeds from sales of available-for-sale-securities	4,298	7,390
Net change in loans	(29,457)	(13,350)
Purchase of premises and equipment and software	(1,505)	(918)
Proceeds from sales or disposal of premises and equipment	(13)	315
Proceeds from sale of foreclosed assets	236	1,657
Net cash (used in) investing activities	(21,669)	(3,122)
Financing Activities		
Net increase in demand deposits, money market, interest checking and savings accounts	25,667	10,452
Net (decrease) in certificates of deposit	(8,640)	(15,910)

Net increase in securities sold under agreements to repurchase	3,206	4,503
Repayment of Federal Home Loan Bank advances	(2,000)	(14,000)
Proceeds from Federal Home Loan Bank advances	16,000	9,000
Proceeds from stock options exercised	17	26
Dividends on Common Stock	(562)	(415)
Repayment of trust preferred securities	(10,310)	-
Proceeds from long-term note	7,000	-
Repayment of notes payable	(589)	(1,022)
Net cash provided by (used in) financing activities	29,789	(7,366)
Increase (decrease) in Cash and Cash Equivalents	8,733	(128)
Cash and Cash Equivalents, Beginning of Year	13,137	19,144
Cash and Cash Equivalents, End of Period	$21,870	$19,016
Supplemental Cash Flows Information		
Interest paid	$3,079	$2,786
Income taxes paid	$1,040	$550
Transfer of loans to foreclosed assets	$285	$915

See notes to condensed consolidated financial statements (unaudited)

SB FINANCIAL GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1—BASIS OF PRESENTATION

SB Financial Group, Inc. (the "Company") is a bank holding company whose principal activity is the ownership and management of its wholly-owned subsidiaries, The State Bank and Trust Company ("State Bank"), RFCBC, Inc. ("RFCBC"), Rurbanc Data Services, Inc. dba RDSI Banking Systems ("RDSI"), and Rurban Statutory Trust II ("RST II"). In addition, State Bank owns all of the outstanding stock of Rurban Mortgage Company ("RMC"), and State Bank Insurance, LLC ("SBI").

The consolidated financial statements include the accounts of the Company, State Bank, RFCBC, RDSI, RMC, and SBI. All significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions for Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The financial statements reflect all adjustments that are, in the opinion of management, necessary to fairly present the financial position, results of operations and cash flows of the Company. Those adjustments consist only of normal recurring adjustments. Results of operations for the three and nine months ended September 30, 2014, are not necessarily indicative of results for the complete year.

The condensed consolidated balance sheet of the Company as of December 31, 2013 has been derived from the audited consolidated balance sheet of the Company as of that date.

For further information, refer to the consolidated financial statements and footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

The following paragraphs summarize the impact of new accounting pronouncements:

Accounting Standards Update (ASU) No. 2014-12 (Topic 718): Compensation – Stock Compensation

The ASU provides guidance for the accounting treatment of share-based payments when the terms provide that a performance target could be achieved after the service period. The treatment requires that the target achievement after the service period be treated as a performance condition. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. Management does not believe this update will have a material impact on the Company's consolidated financial statements.

ASU No. 2014-09 (Topic 606): Revenue from Contracts with Customers

The ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets unless those contracts are within the scope of other standards. The core principle is that an entity should recognize revenue in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Management does not believe that the implementation of this update will have a material impact on the Company's consolidated financial statements.

ASU No. 2014-06: Technical Corrections and Improvements Related Glossary Terms.

A standing project exists on the FASB's agenda to address feedback and to make other incremental improvements to U.S. GAAP. This perpetual project should eliminate the need for periodic agenda requests for narrow and incremental items. The Board decided that the types of issues that it will consider through this project are changes to clarify the Codification or correct unintended application of guidance that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities. This Update is limited to those amendments related to the Master Glossary, including technical corrections related to glossary links, glossary term deletions, and glossary term name changes. In addition, this Update includes more substantive, limited-scope improvements to reduce instances of the same term appearing multiple times in the Master Glossary with similar, but not entirely identical, definitions. Management does not believe these technical corrections will have a material impact on the Company's consolidated financial statements.

ASU No. 2014-04, Receivables (Topic 310): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.

This ASU clarifies that an in substance repossession or foreclosure occurs upon either the creditor obtaining legal title to the residential real estate property or the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. The amendments are effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2014. The amendments may be adopted using either a modified retrospective transition method or a prospective transition method. Early adoption is permitted. Management does not believe the amendments will have a material impact on the Company's consolidated financial statements.

NOTE 2—EARNINGS PER SHARE

Earnings per share (EPS) have been computed based on the weighted average number of shares outstanding during the periods presented. For the three- and nine-month periods ended September 30, 2014, share-based awards totaling 66,570 common shares were not considered in computing diluted EPS as they were anti-dilutive. For the three- and nine-month periods ended September 30, 2013, share-based awards totaling 95,070 common shares were not considered in computing diluted EPS as they were anti-dilutive. The average number of shares used in the computation of basic and diluted earnings per share were:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
(shares in thousands)	**2014**	**2013**	**2014**	**2013**
Basic earnings per share	4,875	4,867	4,873	4,865
Diluted earnings per share	4,900	4,881	4,896	4,877

Note 3 - Securities

The amortized cost and appropriate fair values, together with gross unrealized gains and losses, of securities at September 30, 2014 and December 31, 2013 were as follows:

($ in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Fair Value
Available-for-Sale Securities:				
September 30, 2014:				
U.S. Treasury and Government agencies	$ 18,034	$ 142	$ (40)	$ 18,136
Mortgage-backed securities	43,722	477	(359)	43,840
State and political subdivisions	18,111	1,045	(7)	19,149
Equity securities	23	-	-	23
	$ 79,890	$ 1,664	$ (406)	$ 81,148

($ in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses

				Fair Value
Available-for-Sale Securities:				
December 31, 2013:				
U.S. Treasury and Government agencies	$ 11,305	$ 120	$ (125)	$ 11,300
Mortgage-backed securities	57,322	417	(516)	57,223
State and political subdivisions	17,937	546	(328)	18,155
Money Market Mutual Fund	3,092	-	-	3,092
Equity securities	23	-	-	23
	$ 89,679	$ 1,083	$ (969)	$ 89,793

The amortized cost and fair value of securities available for sale at September 30, 2014, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale	
($'s in thousands)	Amortized Cost	Fair Value
September 30, 2014:		
Within one year	$470	$479
Due after one year through five years	1,866	1,935
Due after five years through ten years	7,319	7,498
Due after ten years	26,490	27,373
	36,145	37,285
Mortgage-backed securities & equity securities	43,745	43,863
	$79,890	$81,148

The fair value of securities pledged as collateral, to secure public deposits and for other purposes, was $72.2 million at September 30, 2014 and $42.3 million at December 31, 2013. The fair value of securities delivered for repurchase agreements was $20.4 million at September 30, 2014 and $17.5 million at December 31, 2013.

Gross gains of $0.06 million resulting from sales of available-for-sale securities, were realized during the nine-month period ending September 30, 2014. There were no realized gains or losses from sales of available-for-sale securities for the three-month period ending September 30, 2014. There were realized gains of $0.05 million from sales of available-for-sale securities for the three- and nine-month periods ending September 30, 2013. The $0.06 million and the $0.05 million gain on sale was a reclassification from accumulated other comprehensive income (OCI) and is included in the net gain on sales of securities. The related $0.02 million and the $0.02 million in tax expense is a reclassification from OCI and is included in the income tax expense line item in the income statement.

Certain investments in debt securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments was $27.2 million at September 30, 2014, and $35.8 million at December 31, 2013, which was approximately 33.5 and 39.9 percent, respectively, of the Company’s available-for-sale investment portfolio at such dates. Based on evaluation of available evidence, including recent changes in market interest rates, credit rating information and information obtained from regulatory filings, management believes the declines in fair value for these securities are temporary. Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment is identified.

9

Securities with unrealized losses, aggregated by investment class and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2014 and December 31, 2013 are as follows:

($ in thousands)	Less than 12 Months		12 Months or Longer		Total	
September 30, 2014	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale Securities:						
U.S. Treasury and Government agencies	$5,043	$ (16)	$2,976	$ (24)	$8,019	$ (40)
Mortgage-backed securities	10,999	(69)	7,315	(290)	18,314	(359)
State and political subdivisions	-	-	844	(7)	844	(7)
	$16,042	$ (85)	$11,135	$ (321)	$27,177	$ (406)

($ in thousands)	Less than 12 Months		12 Months or Longer		Total	
December 31, 2013	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-Sale Securities:						
U.S. Treasury and Government agencies	$3,834	$ (125)	$-	$ -	$3,834	$ (125)
Mortgage-backed securities	24,773	(410)	2,333	(106)	27,106	(516)
State and political subdivisions	4,868	(328)	-	-	4,868	(328)
	$33,475	$ (863)	$2,333	$ (106)	$35,808	$ (969)

The total unrealized loss as of September 30, 2014 in the securities portfolio is contained in 33 percent of the portfolio with a potential loss of $0.4 million, which is down from the $1.0 million unrealized loss at December 31, 2013. The unrealized losses are contained within 22 individual securities and are not segregated by type or duration of security. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concern warrants such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent of the Company to not sell the investment and whether it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost. Management has determined there is no other-than-temporary-impairment on these securities.

NOTE 4 – LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans that management has the intent and ability to hold for the foreseeable future, or until maturity or payoffs, are reported at their outstanding principal balances adjusted for any charge-offs, the allowance for loan losses, any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans. Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term. Generally, all loan classes are placed on non-accrual status not later than 90 days past due, unless the loan is well-secured and in the process of collection. All interest accrued, but not collected, for loans that are placed on non-accrual or charge-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as new information becomes available.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers nonclassified loans and is based on historical charge-off experience and expected loss given default derived from the Company's internal risk rating process. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected on the historical loss or risk rating data.

A loan is considered impaired when, based on current information and events, it is probable that State Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration each of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial, agricultural, and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent.

When State Bank moves a loan to non-accrual status, total unpaid interest accrued to date is reversed from income. Subsequent payments are applied to the outstanding principal balance with the interest portion of the payment recorded on the balance sheet as a contra-loan. Interest received on impaired loans may be realized once all contractual principal amounts are received or when a borrower establishes a history of six consecutive timely principal and interest payments. It is at the discretion of management to determine when a loan is placed back on accrual status upon receipt of six consecutive timely payments.

Large groups of smaller balance homogenous loans are collectively evaluated for impairment. Accordingly, State Bank does not separately identify individual consumer and residential loans for impairment measurements, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

Categories of loans at September 30, 2014 and December 31, 2013 include:

($ in thousands)	Total Loans		Non-Accrual Loans	
	Sep. 2014	Dec. 2013	Sep. 2014	Dec. 2013
Commercial & Industrial	$90,407	$85,368	1,397	2,316
Commercial RE & Construction	212,964	205,301	616	532
Agricultural & Farmland	44,162	39,210	-	-
Residential Real Estate	107,712	99,620	1,015	1,651
Consumer & Other	50,679	47,804	174	345
Total loans, net of unearned income	$505,924	$477,303	$3,202	$4,844
Allowance for loan losses	$(6,713)	$(6,964)		

The following tables present the activity in the allowance for loan losses and the recorded investment in loans based on portfolio segment and impairment method as of September 30, 2014, December 31, 2013 and September 30, 2013.

For the Three Months Ended Sep. 30, 2014

($'s in thousands)	Commercial & Industrial	Commercial RE & Construction	Agricultural & Farmland	Residential Real Estate	Consumer & Other	Total
ALLOWANCE FOR LOAN AND LEASE LOSSES						
Beginning balance	$ 1,660	$ 2,657	$ 194	$ 1,266	$ 791	$6,568
Charge Offs	-	(12)	-	(18)	(63)	(93)
Recoveries	6	64	1	14	3	88
Provision	120	(114)	21	46	77	150
Ending Balance	$ 1,786	$ 2,595	$ 216	$ 1,308	$ 808	$6,713

For the Nine Months Ended Sep. 30, 2014

($'s in thousands)	Commercial & Industrial	Commercial RE & Construction	Agricultural & Farmland	Residential Real Estate	Consumer & Other	Total
ALLOWANCE FOR LOAN AND LEASE LOSSES						

Beginning balance	$ 2,175	$ 2,708	$ 159	$ 1,067	$ 855	$6,964
Charge Offs	(607)	(13)	-	(33)	(93)	(746)
Recoveries	18	124	2	28	23	195
Provision	200	(224)	55	246	23	300
Ending Balance	$ 1,786	$ 2,595	$ 216	$ 1,308	$ 808	$6,713

12

For the Nine Months Ended Sep. 30, 2014

($'s in thousands)	Commercial & Industrial	Commercial RE & Construction	Agricultural & Farmland	Residential Real Estate	Consumer & Other	Total
Loans Receivable at September 30, 2014						
Allowance:						
Ending balance: individually evaluated for impairment	$ 510	$ 16	$ -	$ 167	$ 47	$ 740
Ending balance: collectively evaluated for impairment	$ 1,276	$ 2,579	$ 216	$ 1,141	$ 761	$ 5,973
Loans:						
Ending balance: individually evaluated for impairment	$ 1,278	$ 741	$ -	$ 1,619	$ 524	$ 4,162
Ending balance: collectively evaluated for impairment	$ 89,129	$ 212,223	$ 44,162	$ 106,093	$ 50,155	$ 501,762

($'s in thousands)	Commercial & Industrial	Commercial RE & Construction	Agricultural & Farmland	Residential Real Estate	Consumer & Other	Total
Loans Receivable at December 31, 2013						
Allowance:						
Ending balance: individually evaluated for impairment	$ 1,079	$ 56	$ -	$ 192	$ 168	$ 1,495
Ending balance: collectively evaluated for impairment	$ 1,096	$ 2,652	$ 159	$ 875	$ 687	$ 5,469
Loans:						
Ending balance: individually evaluated for impairment	$ 2,116	$ 649	$ -	$ 1,985	$ 590	$ 5,340
Ending balance: collectively evaluated for impairment	$ 83,252	$ 204,652	$ 39,210	$ 97,635	$ 47,214	$ 471,963

13

($'s in thousands)	Commercial & Industrial	Commercial RE & Construction	Agricultural & Farmland	Residential Real Estate	Consumer & Other	Total
ALLOWANCE FOR LOAN AND LEASE LOSSES						
For the Three Months Ended Sep. 30, 2013						
Beginning balance	$ 1,547	$ 3,059	$ 180	$ 1,183	$ 1,044	$7,013
Charge Offs	-	(53)	-	(69)	(185)	(307)
Recoveries	2	1	1	-	9	13
Provision	183	86	(4)	22	114	401
Ending Balance	$ 1,732	$ 3,093	$ 177	$ 1,136	$ 982	$7,120
For the Nine Months Ended Sep. 30, 2013						
Beginning balance	$ 1,561	$ 3,034	$ 186	$ 1,088	$ 942	$6,811
Charge Offs	(1)	(58)	-	(167)	(430)	(656)
Recoveries	16	16	3	19	11	65
Provision	156	101	(12)	196	459	900
Ending Balance	$ 1,732	$ 3,093	$ 177	$ 1,136	$ 982	$7,120

The risk characteristics of each loan portfolio segment are as follows:

Commercial and Agricultural

Commercial and agricultural loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets, such as accounts receivable or inventory, and may include a personal guarantee. Short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial Real Estate including Construction

Commercial real estate loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The characteristics of properties securing the Company’s commercial real estate portfolio are diverse, but with geographic location almost entirely in the Company’s market area. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. In general, the Company avoids financing single purpose projects unless other underwriting factors are present to help mitigate risk. In addition, management tracks the level of owner-occupied commercial real estate versus non-owner-occupied loans.

Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews and financial analysis of the developers and property owners. Construction loans are generally based on estimates of costs and value associated with the completed project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

Residential and Consumer

Residential and consumer loans consist of two segments – residential mortgage loans and personal loans. Residential mortgage loans are secured by 1-4 family residences and are generally owner-occupied, and the Company generally establishes a maximum loan-to-value ratio and requires private mortgage insurance if that ratio is exceeded. Home equity loans are typically secured by a subordinate interest in 1-4 family residences, and consumer personal loans are secured by consumer personal assets, such as automobiles or recreational vehicles. Some consumer personal loans are unsecured, such as small installment loans and certain lines of credit. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas, such as unemployment levels. Repayment can also be impacted by changes in property values on residential properties. Risk is mitigated by the fact that these loans are of smaller individual amounts and spread over a large number of borrowers.

The following tables present the credit risk profile of the Company’s loan portfolio based on rating category and payment activity as of September 30, 2014 and December 31, 2013.

Sep. 30, 2014 Loan Grade ($ in thousands)	Commercial & Industrial	Commercial RE & Construction	Agricultural & Farmland	Residential Real Estate	Consumer & Other	Total
1-2	$ 887	$ 70	$ 69	$ -	$ -	$ 1,026
3	21,591	53,807	8,528	99,528	46,882	230,336
4	65,996	147,325	35,565	5,603	3,473	257,962
Total Pass	88,474	201,202	44,162	105,131	50,355	489,324
Special Mention	34	6,643	-	1,123	86	7,886
Substandard	752	4,503	-	255	64	5,574
Doubtful	1,147	616	-	1,203	174	3,140
Loss	-	-	-	-	-	-
Total Loans	$ 90,407	$ 212,964	$ 44,162	$ 107,712	$ 50,679	$ 505,924

December 31, 2013 Loan Grade ($ in thousands)	Commercial & Industrial	Commercial RE & Construction	Agricultural & Farmland	Residential Real Estate	Consumer & Other	Total
1-2	$ 1,345	$ 81	$ 76	$ -	$ 87	$ 1,589
3	22,328	44,095	6,543	90,606	43,250	206,822
4	56,188	146,861	32,591	5,700	3,782	245,122
Total Pass	79,861	191,037	39,210	96,306	47,119	453,533
Special Mention	3,159	8,917	-	1,373	86	13,535
Substandard	32	4,815	-	290	84	5,221
Doubtful	2,316	532	-	1,651	515	5,014
Loss	-	-	-	-	-	-
Total Loans	$ 85,368	$ 205,301	$ 39,210	$ 99,620	$ 47,804	$ 477,303

The Company evaluates the loan risk grading system definitions and allowance for loan loss methodology on an ongoing basis.

Credit Risk Profile

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes loans with an outstanding balance greater than $100 thousand and non-homogeneous loans, such as commercial and commercial real estate loans. This analysis is performed on a quarterly basis. The Company uses the following definitions for risk ratings:

Special Mention (5): Assets have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Company's credit position at some future date. Special mention assets are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification. Ordinarily, special mention credits have characteristics which corrective management action would remedy.

Substandard (6): Loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful (7): Loans classified as doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of current known facts, conditions and values, highly questionable and improbable.

Loss (8): Loans are considered uncollectable and of such little value that continuing to carry them as assets on the Company's financial statement is not feasible. Loans will be classified Loss when it is neither practical nor desirable to defer writing off or reserving all or a portion of a basically worthless asset, even though partial recovery may be possible at some time in the future.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass (1-4) rated loans. Pass ratings are assigned to those borrowers that do not have identified potential or well-defined weaknesses and for which there is a high likelihood of orderly repayment. All other categories are updated on a quarterly basis.

The following tables present the Company's loan portfolio aging analysis as of September 30, 2014 and December 31, 2013.

September 30, 2014	**30-59 Days Past Due**	**60-89 Days Past Due**	**Greater Than 90 Days**	**Total Past Due**	**Current**	**Total Loans Receivable**
($ in thousands)						
Commercial & Industrial	$ -	$ -	$ 997	$ 997	$ 89,410	$ 90,407
Commercial RE & Construction	3,713	-	616	4,329	208,635	212,964
Agricultural & Farmland	-	-	-	-	44,162	44,162
Residential Real Estate	118	-	380	498	107,214	107,712
Consumer & Other	108	57	10	175	50,504	50,679
Total Loans	$ 3,939	$ 57	$ 2,003	$ 5,999	$ 499,925	$ 505,924

December 31, 2013	**30-59 Days Past Due**	**60-89 Days Past Due**	**Greater Than 90 Days**	**Total Past Due**	**Current**	**Total Loans Receivable**
($ in thousands)						
Commercial & Industrial	$ -	$ -	$ 1,890	$ 1,890	$ 83,478	$ 85,368
Commercial RE & Construction	424	364	168	956	204,345	205,301
Agricultural & Farmland	-	-	-	-	39,210	39,210
Residential Real Estate	-	14	453	467	99,153	99,620
Consumer & Other	22	34	98	154	47,650	47,804
Total Loans	$ 446	$ 412	$ 2,609	$ 3,467	$ 473,836	$ 477,303

All loans past due 90 days are systematically placed on nonaccrual status.

A loan is considered impaired, in accordance with the impairment accounting guidance (ASC 310-10-35-16), when based on current information and events, it is probable State Bank will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include nonperforming commercial loans but also include loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forebearance or other actions intended to maximize collection.

The following tables present impaired loan information as of and for the nine months ended September 30, 2014 and 2013, and for the twelve months ended December 31, 2013:

Nine Months Ended Sep. 30, 2014

($'s in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial & Industrial	$ 316	$ 316	$ -	$ 316	$ -
Commercial RE & Construction	560	560	-	578	-
Agricultural & Farmland	-	-	-	-	-
Residential Real Estate	654	697	-	813	41
Consumer & Other	99	105	-	120	8
All Impaired Loans < $100,000	660	660	-	660	-
With a specific allowance recorded:					
Commercial & Industrial	962	1,562	510	1,622	-
Commercial RE & Construction	181	181	16	185	8
Agricultural & Farmland	-	-	-	-	-
Residential Real Estate	965	965	167	1,026	29
Consumer & Other	426	426	47	452	18
Totals:					
Commercial & Industrial	$ 1,278	$ 1,878	$ 510	$ 1,938	$ -
Commercial RE & Construction	$ 741	$ 741	$ 16	$ 763	$ 8
Agricultural & Farmland	$ -	$ -	$ -	$ -	$ -
Residential Real Estate	$ 1,619	$ 1,662	$ 167	$ 1,839	$ 70
Consumer & Other	$ 525	$ 531	$ 47	$ 512	$ 26
All Impaired Loans < $100,000	$ 660	$ 660	$ -	$ 660	$ -

Three Months Ended Sep. 30, 2014

($'s in thousands)	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:		
Commercial & Industrial	$ 316	$ -
Commercial RE & Construction	566	-
Agricultural & Farmland	-	-
Residential Real Estate	808	14
Consumer & Other	115	3
All Impaired Loans < $100,000	660	-
With a specific allowance recorded:		
Commercial & Industrial	1,578	-
Commercial RE & Construction	182	2
Agricultural & Farmland	-	-
Residential Real Estate	1,020	8
Consumer & Other	446	6
Totals:		
Commercial & Industrial	$ 1,894	$ -
Commercial RE & Construction	$ 748	$ 2
Agricultural & Farmland	$ -	$ -
Residential Real Estate	$ 1,828	$ 22
Consumer & Other	$ 561	$ 9
All Impaired Loans < $100,000	$ 660	$ -

Twelve Months Ended December 31, 2013

($'s in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial & Industrial	$ 316	$ 316	$ -
Commercial RE & Construction	389	442	-
Agricultural & Farmland	-	-	-
Residential Real Estate	1,131	1,131	-
Consumer & Other	252	252	-
All Impaired Loans < $100,000	1,242	1,242	-
With a specific allowance recorded:			
Commercial & Industrial	1,800	1,800	1,079
Commercial RE & Construction	260	260	56
Agricultural & Farmland	-	-	-
Residential Real Estate	854	854	192
Consumer & Other	338	338	168
Totals:			

Commercial & Industrial	$ 2,116	$ 2,116	$ 1,079
Commercial RE & Construction	$ 649	$ 702	$ 56
Agricultural & Farmland	$ -	$ -	$ -
Residential Real Estate	$ 1,985	$ 1,985	$ 192
Consumer & Other	$ 590	$ 590	$ 168
All Impaired Loans < $100,000	$ 1,242	$ 1,242	$ -

	Nine Months Ended Sep. 30, 2013		Three Months Ended Sep. 30, 2013	
($'s in thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Commercial & Industrial	$ 2,341	$ 13	$ 870	$ 4
Commercial RE & Construction	820	19	805	5
Agricultural & Farmland	-	-	-	-
Residential Real Estate	1,160	35	1,156	12
Home Equity Consumer & Other	203	8	199	3
All Impaired Loans < $100,000	1,065	-	1,065	-
With a specific allowance recorded:				
Commercial & Industrial	1,773	44	1,800	12
Commercial RE & Construction	261	8	259	3
Agricultural & Farmland	-	-	-	-
Residential Real Estate	983	36	978	12
Home Equity Consumer & Other	445	22	438	7
Totals:				
Commercial & Industrial	$ 4,114	$ 57	$ 2,670	$ 16
Commercial RE & Construction	$ 1,081	$ 27	$ 1,064	$ 8
Agricultural & Farmland	$ -	$ -	$ -	$ -
Residential Real Estate	$ 2,143	$ 71	$ 2,134	$ 24
Consumer & Other	$ 648	$ 30	$ 637	$ 10
All Impaired Loans < $100,000	$ 1,065	$ -	$ 1,065	$ -

Impaired loans less than $100,000 are included in groups of homogenous loans. These loans are evaluated based on delinquency status.

Interest income recognized on a cash basis does not materially differ from interest income recognized on an accrual basis.

Troubled Debt Restructured (TDR) Loans

TDRs are modified loans where a concession was provided to a borrower experiencing financial difficulties. Loan modifications are considered TDRs when the concessions provided are not available to the borrower through either normal channels or other sources. However, not all loan modifications are TDRs.

TDR Concession Types

The Company’s standards relating to loan modifications consider, among other factors, minimum verified income requirements, cash flow analysis, and collateral valuations. Each potential loan modification is reviewed individually and the terms of the loan are modified to meet a borrower’s specific circumstances at a point in time. All loan modifications, including those classified as TDRs, are reviewed and approved. The types of concessions provided to borrowers include:

Interest rate reduction: A reduction of the stated interest rate to a nonmarket rate for the remaining original life of the debt. The Company also may grant interest rate concessions for a limited timeframe on a case by case basis.

Amortization or maturity date change: A change in the amortization or maturity date beyond what the collateral supports, including a concession that does any of the following:

(1) Lengthens the amortization period of the amortized principal beyond market terms. This concession reduces the minimum monthly payment and increases the amount of the balloon payment at the end of the term of the loan. Principal is generally not forgiven.

(2) Reduces the amount of loan principal to be amortized. This concession also reduces the minimum monthly payment and increases the amount of the balloon payment at the end of the term of the loan. Principal is generally not forgiven.

(3) Extends the maturity date or dates of the debt beyond what the collateral supports. This concession generally applies to loans without a balloon payment at the end of the term of the loan. In addition, there may be instances where renewing loans potentially require non-market terms and would then be reclassified as TDRs.

Other: A concession that is not categorized as one of the concessions described above. These concessions include, but are not limited to: principal forgiveness, collateral concessions, covenant concessions, and reduction of accrued interest. Principal forgiveness may result from any TDR modification of any concession type.

The following presents the activity of TDRs during the three and nine months ended September 30, 2014, and September 30, 2013.

	Three Months Ended September 30, 2014		
($ in thousands)	Number of Loans	Pre-Modification Recorded Balance	Post Modification Recorded Balance
Residential Real Estate	-	$-	$-
Consumer & Other	-	-	-
Total Modifications	-	$-	$-

($ in thousands)	Interest Only	Term	Combination	Total Modification
Residential Real Estate	$-	$-	$-	$-
Consumer & Other	-	-	-	-
Total Modifications	$-	$-	$-	$-

20

There was no increase in the allowance for loan and lease losses ("ALLL") due to TDRs in the three month period ended September 30, 2014.

	Nine Months Ended September 30, 2014		
($ in thousands)	Number of Loans	Pre-Modification Recorded Balance	Post Modification Recorded Balance
Residential Real Estate	-	$-	$-
Consumer & Other	-	-	-
Total Modifications	-	$-	$-

($ in thousands)	Interest Only	Term	Combination	Total Modification
Residential Real Estate	$-	$-	$-	$-
Consumer & Other	-	-	-	-
Total Modifications	$-	$-	$-	$-

There was no increase in the allowance for loan and lease losses ("ALLL") due to TDRs in the nine month period ended September 30, 2014.

	Three Months Ended September 30, 2013		
($ in thousands)	Number of Loans	Pre-Modification Recorded Balance	Post Modification Recorded Balance
Residential Real Estate	-	$-	$-
Consumer & Other	-	-	-
Total Modifications	-	$-	$-

($ in thousands)	Interest Only	Term	Combination	Total Modification
Residential Real Estate	$-	$-	$-	$-
Consumer & Other	-	-	-	-

Total Modifications	$-	$-	$-	$-

There was no increase in the allowance for loan and lease losses ("ALLL") due to TDRs in the three month period ended September 30, 2013.

	Nine Months Ended Sep. 30, 2013		
($ in thousands)	Number of Loans	Pre-Mod Balance	Post-Mod Balance