

MIDDLEFIELD BANC CORP  
Form 10-Q  
May 09, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20552

FORM 10 - Q

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

For the quarterly period ended March 31, 2013

Commission File Number 000-32561

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

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

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

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

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

YES  NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definition of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Small reporting company

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

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

Class: Common Stock, without par value  
Outstanding at May 9, 2013: 2,016,496

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## MIDDLEFIELD BANC CORP.

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MIDDLEFIELD BANC CORP.  
CONSOLIDATED BALANCE SHEET  
(Dollar amounts in thousands, except share data)  
(Unaudited)

	March 31, 2013	December 31, 2012
<b>ASSETS</b>		
Cash and due from banks	\$32,426	\$33,568
Federal funds sold	13,204	11,778
Cash and cash equivalents	45,630	45,346
Investment securities available for sale	190,687	194,472
Loans	407,054	408,433
Less allowance for loan losses	7,732	7,779
Net loans	399,322	400,654
Premises and equipment	8,694	8,670
Goodwill	4,559	4,559
Core deposit intangible	184	195
Bank-owned life insurance	8,604	8,536
Accrued interest and other assets	9,294	7,856
<b>TOTAL ASSETS</b>	<b>\$666,974</b>	<b>\$670,288</b>
<b>LIABILITIES</b>		
Deposits:		
Noninterest-bearing demand	\$73,354	\$75,912
Interest-bearing demand	68,060	63,915
Money market	80,051	81,349
Savings	181,872	175,406
Time	188,160	196,753
Total deposits	591,497	593,335
Short-term borrowings	5,240	6,538
Other borrowings	12,779	12,970
Accrued interest and other liabilities	1,608	2,008
<b>TOTAL LIABILITIES</b>	<b>611,124</b>	<b>614,851</b>
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, no par value; 10,000,000 shares authorized, 2,205,814 and 2,181,763 shares issued	34,697	34,295
Retained earnings	23,622	22,485
Accumulated other comprehensive income	4,265	5,391
Treasury stock, at cost; 189,530 shares	(6,734 )	(6,734 )
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>55,850</b>	<b>55,437</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$666,974</b>	<b>\$670,288</b>

See accompanying notes to the unaudited consolidated financial statements.



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

	Three Months Ended March 31,	
	2013	2012
<b>INTEREST INCOME</b>		
Interest and fees on loans	\$5,572	\$5,537
Interest-bearing deposits in other institutions	8	4
Federal funds sold	4	3
Investment securities:		
Taxable interest	674	915
Tax-exempt interest	733	747
Dividends on stock	23	26
<b>Total interest income</b>	<b>7,014</b>	<b>7,232</b>
<b>INTEREST EXPENSE</b>		
Deposits	1,297	1,497
Short term borrowings	52	59
Other borrowings	46	84
Trust preferred debt	34	46
<b>Total interest expense</b>	<b>1,429</b>	<b>1,686</b>
<b>NET INTEREST INCOME</b>	<b>5,585</b>	<b>5,546</b>
Provision for loan losses	313	600
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>5,272</b>	<b>4,946</b>
<b>NONINTEREST INCOME</b>		
Service charges on deposit accounts	447	431
Investment securities gains, net	185	-
Earnings on bank-owned life insurance	68	68
Gain on sale of loans	-	85
Other income	168	210
<b>Total noninterest income</b>	<b>868</b>	<b>794</b>
<b>NONINTEREST EXPENSE</b>		
Salaries and employee benefits	1,871	1,750
Occupancy expense	274	248
Equipment expense	189	170
Data processing costs	213	199
Ohio state franchise tax	154	129
Federal deposit insurance expense	154	243
Professional fees	276	214
Loss on sale of other real estate owned	8	18
Advertising expense	112	20

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Other real estate expense	106	10
Other expense	644	781
Total noninterest expense	4,001	3,782
<b>Income before income taxes</b>		
	2,139	1,958
Income taxes	482	435
NET INCOME	\$1,657	\$1,523
<b>EARNINGS PER SHARE</b>		
Basic	\$0.83	\$0.86
Diluted	0.82	0.86
<b>DIVIDENDS DECLARED PER SHARE</b>		
	\$0.26	\$0.26

See accompanying notes to the unaudited consolidated financial statements.



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

	Three Months Ended March 31,	
	2013	2012
Net income	\$1,657	\$1,523
Other comprehensive loss:		
Net unrealized holding loss on available for sale securities	(1,521 )	(60 )
Tax effect	517	20
Reclassification adjustment for gains included in net income	(185 )	-
Tax effect	63	-
Total other comprehensive loss	(1,126 )	(40 )
Comprehensive income	\$531	\$1,483

See accompanying notes to the unaudited consolidated financial statements.

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

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2012	\$ 34,295	\$ 22,485	\$ 5,391	\$ (6,734 )	\$ 55,437
Net income		1,657			1,657
Comprehensive loss			(1,126 )		(1,126 )
Common stock issuance (13,320 shares)	213				213
Dividend reinvestment and purchase plan (10,731 shares)	300				300
Stock options exercised	(111 )				(111 )
Cash dividends (\$0.26 per share)		(520 )			(520 )
Balance, March 31, 2013	\$ 34,697	\$ 23,622	\$ 4,265	\$ (6,734 )	\$ 55,850

See accompanying notes to the unaudited consolidated financial statements.

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

	Three Months Ended March 31,	
	2013	2012
<b>OPERATING ACTIVITIES</b>		
Net income	\$1,657	\$1,523
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	313	600
Investment securities gains, net	185	-
Depreciation and amortization	222	221
Amortization of premium and discount on investment securities	183	224
Accretion of deferred loan fees, net	(33)	(55)
Origination of loans held for sale	-	(1,084)
Proceeds from sale of loans held for sale	-	1,169
Gain on sale of loans	-	(85)
Earnings on bank-owned life insurance	(68)	(68)
Deferred income taxes	58	(28)
Loss on sale of other real estate owned	8	18
Increase in accrued interest receivable	(529)	(442)
Decrease in accrued interest payable	(24)	(104)
Decrease in prepaid federal deposit insurance	9	211
Other, net	(507)	(523)
Net cash provided by operating activities	1,474	1,577
<b>INVESTING ACTIVITIES</b>		
Investment securities available for sale:		
Proceeds from repayments and maturities	6,773	18,533
Proceeds from sale of securities	7,438	-
Purchases	(12,500)	(8,611)
Increase (decrease) in loans, net	598	(2,643)
Proceeds from the sale of other real estate owned	137	210
Purchase of premises and equipment	(191)	(253)
Net cash provided by investing activities	2,255	7,236
<b>FINANCING ACTIVITIES</b>		
Net (decrease) increase in deposits	(1,838)	2,980
Decrease in short-term borrowings, net	(1,298)	(27)
Repayment of other borrowings	(191)	(270)
Common stock issuance	213	-
Stock options exercised	(111)	-
Proceeds from dividend reinvestment & purchase plan	300	180
Cash dividends	(520)	(457)
Net cash (used for) provided by financing activities	(3,445)	2,406

Increase in cash and cash equivalents	284	11,219
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	45,346	34,390
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$45,630	\$45,609

**SUPPLEMENTAL INFORMATION**

Cash paid during the year for:

Interest on deposits and borrowings	\$1,453	\$1,790
Income taxes	555	200

Non-cash investing transactions:

Transfers from loans to other real estate owned	\$454	\$157
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See accompanying notes to the unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

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

The accompanying financial statements have been prepared in accordance with U.S. generally accepted accounting principles and the instructions for Form 10-Q and Article 10 of Regulation S-X. In management's opinion, the financial statements include all adjustments, consisting of normal recurring adjustments, that the Company considers necessary to fairly state the Company's financial position and the results of operations and cash flows. The consolidated balance sheet at December 31, 2012, has been derived from the audited financial statements at that date but does not include all of the necessary informational disclosures and footnotes as required by U. S. generally accepted accounting principles. The accompanying financial statements should be read in conjunction with the financial statements and notes thereto included with the Company's Form 10-K for the year ended December 31, 2012 (File No. 000-32561). The results of the Company's operations for any interim period are not necessarily indicative of the results of the Company's operations for any other interim period or for a full fiscal year.

Recent Accounting Pronouncements

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

In January 2013, the FASB issued ASU 2013-01, Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. The amendments clarify that the scope of Update 2011-11 applies to derivatives accounted for in accordance with Topic 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with Section 210-20-45 or Section 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. An entity is required to apply the amendments for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the required disclosures retrospectively for all comparative periods presented. The effective date is the same as the effective date of Update 2011-11. This ASU did not 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 Company has provided the necessary disclosures in Note 5.

In February 2013, the FASB issued ASU 2013-04, Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date. The objective of the amendments in this Update is to provide guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date, except for obligations addressed within existing guidance in U.S. generally accepted accounting principles (GAAP). Examples of obligations within the scope of this Update include debt arrangements, other contractual obligations, and settled litigation and judicial rulings. U.S. GAAP does not include specific guidance on accounting for such obligations with joint and several liability, which has resulted in diversity in practice. Some entities record the entire amount under the joint and several liability arrangement on the basis of the concept of a liability and the guidance that must be met to extinguish a liability. Other entities record less than the total amount of the obligation, such as an amount allocated, an amount corresponding to the proceeds received, or the portion of the amount the entity agreed to pay among its co-obligors, on the basis of the guidance for contingent liabilities. 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 ending after December 15, 2014, and interim periods and annual periods thereafter. This ASU is not expected to have a significant impact on the Company's financial statements.

#### NOTE 2 - STOCK-BASED COMPENSATION

The Company has no unvested stock options outstanding or unrecognized stock-based compensation costs outstanding as of March 31, 2013. The company had 9,000 unvested stock options outstanding but no unrecognized stock-based compensation costs outstanding as of March 31, 2012. Those options vested on May 9, 2012.

Stock option activity during the three months ended March 31 as follows:

	2013	Weighted- average Exercise Price	2012	Weighted- average Exercise Price
Outstanding, January 1	79,693	\$ 27.25	88,774	\$ 26.81
Exercised	18,561	24.08	-	-
Outstanding, March 31	61,132	\$ 28.21	88,774	\$ 26.81
Exercisable, March 31	61,132	\$ 28.21	88,774	\$ 26.81



## NOTE 3 - EARNINGS PER SHARE

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

The following table sets forth the composition of the weighted-average common shares (denominator) used in the basic and diluted earnings per share computation.

	For the Three Months Ended March 31,	
	2013	2012
Weighted average common shares outstanding	2,189,175	1,953,512
Average treasury stock shares	(189,530 )	(189,530 )
Weighted average common shares and common stock equivalents used to calculate basic earnings per share	1,999,645	1,763,982
Additional common stock equivalents (stock options) used to calculate diluted earnings per share	10,647	603
Weighted average common shares and common stock equivalents used to calculate diluted earnings per share	2,010,292	1,764,585

Options to purchase 61,132 shares of common stock, at prices ranging from \$17.55 to \$40.24, were outstanding during the three months ended March 31, 2013. Of those options, 59,617 were considered dilutive based on the market price exceeding the strike price. The remaining 1,515 options had no dilutive effect on earnings per share.

Options to purchase 88,774 shares of common stock, at prices ranging from \$17.55 to \$40.24, were outstanding during the three months ended March 31, 2012. Of those options, 9,000 were considered dilutive based on the market price exceeding the strike price. The remaining 79,774 options had no dilutive effect on earnings per share.



## NOTE 4 - FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants at the measurement date. GAAP established a fair value hierarchy that prioritizes the use of inputs used in valuation methodologies into the following three levels:

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

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

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

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

March 31, 2013

(Dollar amounts in thousands)	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
U.S. government agency securities	\$ -	\$ 25,752	\$ -	\$ 25,752
Obligations of states and political subdivisions	-	94,462	-	94,462
Mortgage-backed securities in government-sponsored entities	-	65,026	-	65,026
Private-label mortgage-backed securities	-	4,697	-	4,697
Total debt securities	-	189,937	-	189,937
Equity securities in financial institutions	5	745	-	750
Total	\$ 5	\$ 190,682	\$ -	\$ 190,687

December 31, 2012

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

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

Financial instruments are considered Level III when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. In addition to these unobservable inputs, the valuation models for Level III financial instruments typically also rely on a number of inputs that are readily observable either directly or indirectly. Level III financial instruments also include those for which the determination of fair value requires significant management judgment or estimation. The Company has no securities considered to be Level III as of March 31, 2013.

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

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

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

March 31, 2013

(Dollar amounts in thousands)	Level I	Level II	Level III	Total
Assets measured on a non-recurring basis:				
Impaired loans	\$ -	\$ -	\$ 16,363	\$ 16,363
Other real estate owned	-	-	2,155	2,155

December 31, 2012

	Level I	Level II	Level III	Total
Assets measured on a non-recurring basis:				
Impaired loans	\$ -	\$ -	\$ 17,600	\$ 17,600
Other real estate owned	-	-	1,846	1,846

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

## Quantitative Information about Level III Fair Value Measurements

(unaudited, in thousands)	Estimate		Valuation Technique	Unobservable Input
	March 31, 2013	December 31, 2012		
Impaired loans	\$ 16,363	17,600	Appraisal of collateral (1)	Appraisal adjustments (2) Liquidation expenses (2)
Other real estate owned	\$ 2,155	1,846	Appraisal of collateral (1), (3)	

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various level 3 inputs which are not identifiable.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

(3) Includes qualitative adjustments by management and estimated liquidation expenses.

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

	Carrying Value	March 31, 2013			Total Fair Value
		Level I	Level II (in thousands)	Level III	
<b>Financial assets:</b>					
Cash and cash equivalents	\$45,630	\$45,630	\$-	\$-	\$45,630
<b>Investment securities available for sale</b>					
Investment securities available for sale	190,687	5	190,682	-	190,687
Net loans	399,322	-	-	402,219	402,219
Bank-owned life insurance	8,604	8,604	-	-	8,604
Federal Home Loan Bank stock	1,627	1,627	-	-	1,627
Accrued interest receivable	2,692	2,692	-	-	2,692
<b>Financial liabilities:</b>					
Deposits	\$591,497	\$403,337	\$-	\$190,881	\$594,218
Short-term borrowings	5,240	5,240	-	-	5,240
Other borrowings	12,779	-	-	13,092	13,092
Accrued interest payable	468	468	-	-	468

	Carrying Value	December 31, 2012			Total Fair Value
		Level I	Level II (in thousands)	Level III	
<b>Financial assets:</b>					
Cash and cash equivalents	\$45,346	\$45,346	\$-	\$-	\$45,346
<b>Investment securities available for sale</b>					
Investment securities available for sale	194,472	5	194,467	-	194,472
Net loans	400,654	-	-	390,206	390,206
Bank-owned life insurance	8,536	8,536	-	-	8,536
Federal Home Loan Bank stock	1,887	1,887	-	-	1,887
Accrued interest receivable	2,163	2,163	-	-	2,163
<b>Financial liabilities:</b>					
Deposits	\$593,335	\$396,582	\$-	\$196,122	\$592,704
Short-term borrowings	6,538	6,538	-	-	6,538
Other borrowings	12,970	-	-	13,337	13,337
Accrued interest payable	492	492	-	-	492

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

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

instrument.

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

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

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

Cash and Cash Equivalents, Federal Home Loan Bank Stock, Accrued Interest Receivable, Accrued Interest Payable, and Short-Term Borrowings

The fair value is equal to the current carrying value.

Bank-Owned Life Insurance

The fair value is equal to the cash surrender value of the life insurance policies.

Investment Securities Available for Sale

The fair value of investment securities is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities.

Loans

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

Deposits and Other Borrowed Funds

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

Commitments to Extend Credit

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

#### NOTE 5 – ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table presents the changes in accumulated other comprehensive income by component net of tax for the three months ended March 31, 2013:

	Unrealized gains on available for sale securities (a)
Balance as of December 31, 2012	\$5,391
Other comprehensive loss before reclassification	(1,004 )
Amount reclassified from accumulated other comprehensive income	(122 )
Total other comprehensive loss	(1,126 )
Balance as of March 31, 2013	\$4,265

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

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The following table presents significant amounts reclassified out of each component of accumulated other comprehensive income for the three months ended March 31, 2013:

Details about other comprehensive income	Amount Reclassified from Accumulated Other Comprehensive Income (a)	Affected Line Item in the Statement Where Net Income is Presented
Unrealized gains on available for sale securities		Investment securities gains, net
	\$ 185	
	(63)	) Income taxes
	\$ 122	Net of tax

#### NOTE 6 - INVESTMENT SECURITIES AVAILABLE FOR SALE

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

(Dollar amounts in thousands)	March 31, 2013			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
U.S. government agency securities	\$ 25,277	\$ 556	\$ (81 )	\$ 25,752
Obligations of states and political subdivisions:				
Taxable	5,892	597	-	6,489
Tax-exempt	84,379	3,985	(391 )	87,973
Mortgage-backed securities in government-sponsored entities	63,710	1,481	(165 )	65,026
Private-label mortgage-backed securities	4,216	481	-	4,697
Total debt securities	183,474	7,100	(637 )	189,937
Equity securities in financial institutions	750	-	-	750
Total	\$ 184,224	\$ 7,100	\$ (637 )	\$ 190,687



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

The amortized cost and fair value of debt securities at March 31, 2013, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollar amounts in thousands)	Amortized Cost	Fair Value
Due in one year or less	\$ 2,915	\$ 2,985
Due after one year through five years	4,543	4,811
Due after five years through ten years	21,842	22,805
Due after ten years	154,174	159,336
Total	\$ 183,474	\$ 189,937

Proceeds from the sales of securities available-for-sale and the gross realized gains and losses for the three months ended March 31 are as follows:

	2013	2012
Proceeds from sales	\$ 7,438	-
Gross realized gains	204	-
Gross realized losses	(19 )	-

Investment securities with an approximate carrying value of \$66,318,142 and \$52,126,000 at March 31, 2013 and 2012, respectively, were pledged to secure deposits and other purposes as required by law.

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

(Dollar amounts in thousands)	Less than Twelve Months		March 31, 2013 Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government agency securities	\$ 11,925	\$ (81 )	\$ -	\$ -	\$ 11,925	\$ (81 )
Obligations of states and political subdivisions	14,834	(391 )	-	-	14,834	(391 )
Mortgage-backed securities in government-sponsored entities	15,768	(165 )	-	-	15,768	(165 )
Total	\$ 42,527	\$ (637 )	\$ -	\$ -	\$ 42,527	\$ (637 )

	Less than Twelve Months		December 31, 2012 Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government agency securities	\$ 9,938	\$ (91 )	\$ -	\$ -	\$ 9,938	\$ (91 )
Obligations of states and political subdivisions	9,240	(104 )	-	-	9,240	