MIDDLEFIELD BANC CORP
Form 10-Q
May 13, 2014

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, 2014

Commission File Number 000-32561

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

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

15985 East High Street, Middlefield, Ohio 44062-9263

(Address of principal executive offices)

(440) 632-1666

(Registrant's telephone number, including area code)

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

YES [√] NO [ ]

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES [ ]   NO [√]

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

Class: Common Stock, without par value

Outstanding at May 13, 2014: 2,038,143

MIDDLEFIELD BANC CORP.

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MIDDLEFIELD BANC CORP.

CONSOLIDATED BALANCE SHEET

(Dollar amounts in thousands, except share data)

(Unaudited)

	March 31, 2014	December 31, 2013
ASSETS		
Cash and due from banks	$28,663	$20,926
Federal funds sold	14,147	5,267
Cash and cash equivalents	42,810	26,193
Investment securities available for sale	155,940	157,143
Loans	443,729	435,725
Less Allowance for loan and lease losses	7,015	7,046
Net loans	436,714	428,679
Premises and equipment, net	9,797	9,828
Goodwill	4,559	4,559
Core deposit intangible	146	156
Bank-owned life insurance	8,883	8,816
Accrued interest and other assets	11,173	11,716
TOTAL ASSETS	$670,022	$647,090
LIABILITIES		
Deposits:		
Noninterest-bearing demand	$88,988	$85,905
Interest-bearing demand	60,673	53,741
Money market	75,296	77,473
Savings	179,805	177,303
Time	190,004	174,414
Total deposits	594,766	568,836
Short-term borrowings	5,320	10,809
Other borrowings	11,468	11,609
Accrued interest and other liabilities	1,774	2,363
TOTAL LIABILITIES	613,328	593,617
STOCKHOLDERS' EQUITY		
	35,115	34,979

Common stock, no par value; 10,000,000 shares authorized, 2,226,889 and 2,221,834 shares issued; 2,037,359 and 2,032,304 shares outstanding		
Retained earnings	28,699	27,465
Accumulated other comprehensive loss	(386)	(2,237)
Treasury stock, at cost; 189,530 shares	(6,734)	(6,734)
TOTAL STOCKHOLDERS' EQUITY	56,694	53,473
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$670,022	$647,090

See accompanying notes to unaudited consolidated financial statements.

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MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF INCOME

(Dollar amounts in thousands, except per share data)

(Unaudited)

	Three Months Ended March 31, 2014	2013
INTEREST INCOME		
Interest and fees on loans	$5,694	$5,572
Interest-bearing deposits in other institutions	5	8
Federal funds sold	3	4
Investment securities:		
Taxable interest	509	674
Tax-exempt interest	755	733
Dividends on stock	23	23
Total interest income	6,989	7,014
INTEREST EXPENSE		
Deposits	940	1,297
Short-term borrowings	35	52
Other borrowings	32	46
Trust preferred securities	26	34
Total interest expense	1,033	1,429
NET INTEREST INCOME	5,956	5,585
Provision for loan losses	180	313
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	5,776	5,272
NONINTEREST INCOME		
Service charges on deposit accounts	441	447
Investment securities (losses) gains, net	(6)	185
Earnings on bank-owned life insurance	67	68
Other income	213	168
Total noninterest income	715	868
NONINTEREST EXPENSE		
Salaries and employee benefits	2,016	1,871
Occupancy expense	321	274

Equipment expense	220	189
Data processing costs	214	213
Ohio state franchise tax	83	154
Federal deposit insurance expense	132	154
Professional fees	287	276
(Gain) loss on sale of other real estate owned	(5)	8
Advertising expense	123	112
Other real estate expense	63	106
Directors fees	86	105
Other expense	689	539
Total noninterest expense	4,229	4,001
Income before income taxes	2,262	2,139
Income taxes	499	482
NET INCOME	$1,763	$1,657
EARNINGS PER SHARE		
Basic	$0.87	$0.83
Diluted	0.86	0.82
DIVIDENDS DECLARED PER SHARE	$0.26	$0.26

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(Dollar amounts in thousands)

(Unaudited)

	Three Months Ended March 31,	
	2014	2013
Net income	$1,763	$1,657
Other comprehensive income (loss):		
Net unrealized holding gain (loss) on available-for-sale securities	2,799	(1,521)
Tax effect	(952)	517
Reclassification adjustment for investment securities losses (gains) included in net income	6	(185)
Tax effect	(2)	63
Total other comprehensive income (loss)	1,851	(1,126)
Comprehensive income	$3,614	$531

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

(Dollar amounts in thousands, except share data)

(Unaudited)

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2013	$ 34,979	$ 27,465	$ (2,237)	$ (6,734)	$ 53,473
Net income		1,763			1,763
Other Comprehensive income			1,851		1,851
Dividend reinvestment and purchase plan (5,055 shares)	136				136
Cash dividends ($0.26 per share)		(529)			(529)
Balance, March 31, 2014	$ 35,115	$ 28,699	$ (386)	$ (6,734)	$ 56,694

See accompanying notes to unaudited consolidated financial statements.

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MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF CASH FLOWS

(Dollar amounts in thousands)

(Unaudited)

	Three Months Ended March 31, 2014	2013
OPERATING ACTIVITIES		
Net income	$1,763	$1,657
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	180	313
Investment securities losses (gains), net	6	(185)
Depreciation and amortization	202	222
Amortization of premium and discount on investment securities, net	182	183
Accretion of deferred loan fees, net	(76)	(33)
Earnings on bank-owned life insurance	(67)	(68)
Deferred income taxes	(156)	58
(Gain) loss on sale of other real estate owned	(5)	8
Increase in accrued interest receivable	(391)	(529)
Decrease in accrued interest payable	(19)	(24)
Other, net	(481)	(128)
Net cash provided by operating activities	1,138	1,474
INVESTING ACTIVITIES		
Investment securities available for sale:		
Proceeds from repayments and maturities	3,306	6,773
Proceeds from sale of securities	514	7,438
Purchases	-	(12,500)
(Increase) decrease in loans, net	(8,139)	598
Proceeds from the sale of other real estate owned	47	137
Purchases of premises and equipment	(156)	(191)
Net cash (used for) provided by investing activities	(4,428)	2,255
FINANCING ACTIVITIES		
Net (decrease) increase in deposits	25,930	(1,838)
Decrease in short-term borrowings, net	(5,489)	(1,298)
Repayment of other borrowings	(141)	(191)
Common stock issuance	-	213
Stock options exercised	-	(111)
Proceeds from dividend reinvestment and purchase plan	136	300

Cash dividends paid	(529)	(520)
Net cash provided by (used for) financing activities	19,907	(3,445)
Increase in cash and cash equivalents	16,617	284
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	26,193	45,346
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$42,810	$45,630
SUPPLEMENTAL INFORMATION		
Cash paid during the year for:		
Interest on deposits and borrowings	$1,052	$1,453
Income taxes	610	555
Noncash investing transactions:		
Transfers from loans to other real estate owned	$-	$454

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

The consolidated financial statements of Middlefield Banc Corp. ("Company") include its bank subsidiary, The Middlefield Banking Company ("MB"), and a nonbank 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, 2013, 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, 2013 (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 June 2013, the FASB issued ASU 2013-08, *Financial Services – Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements.* The amendments in this Update affect the scope, measurement, and disclosure requirements for investment companies under U.S. GAAP. The amendments do all of the following: 1. Change the approach to the investment company assessment in Topic 946, clarify the characteristics of an investment company, and provide comprehensive guidance for assessing whether an entity is an investment Company. 2. Require an investment company to measure noncontrolling ownership interests in other investment companies at fair value rather than using the equity method of accounting. 3. Require the following additional disclosures: (a) the fact that the entity is an investment company and is applying the guidance in Topic 946, (b) information about changes, if any, in an entity's status as an investment company, and (c) information about financial support provided or contractually required to be provided by an investment company to any of its investees. The amendments in this Update are effective for an entity's interim and annual reporting periods in fiscal years that begin after December 15, 2013. This ASU became effective for the Company on January 1, 2014 and did not have a significant impact on the Company's financial statements.

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. This ASU became effective for the Company on January 1, 2014 and did not have a significant impact on the Company’s financial statements.

In January 2014, FASB issued ASU 2014-01, *Investments – Equity Method and Join Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects.* The amendments in this Update permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments in this Update should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this Update are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. This ASU is not expected to have a significant impact on the Company’s financial.

In January 2014, the FASB issued ASU 2014-04, *Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.* The amendments in this Update clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) 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. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this Update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in this Update using either a modified retrospective transition method or a prospective transition method. This ASU is not expected to have a significant impact on the Company’s financial statements.

NOTE 2 - STOCK-BASED COMPENSATION

The Company had no unvested stock options outstanding or unrecognized stock-based compensation costs outstanding as of March 31, 2014 and 2013.

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

	2014	Weighted-average Exercise Price	2013	Weighted-average Exercise Price
Outstanding, January 1	58,581	$ 28.38	79,693	$ 27.25
Exercised	-	-	18,561	24.08
Outstanding, March 31	58,581	$ 28.38	61,132	$ 28.21
Exercisable, March 31	58,581	$ 28.38	61,132	$ 28.21

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,	
	2014	2013
Weighted average common shares outstanding	2,223,010	2,189,175
Average treasury stock shares	(189,530)	(189,530)
Weighted average common shares and common stock equivalents used to calculate basic earnings per share	2,033,480	1,999,645
Additional common stock equivalents (stock options) used to calculate diluted earnings per share	6,035	10,647
Weighted average common shares and common stock equivalents used to calculate diluted earnings per share	2,039,515	2,010,292

Options to purchase 58,581 shares of common stock, at prices ranging from $17.55 to $40.24, were outstanding during the three months ended March 31, 2014. Of those options, 27,375 were considered dilutive based on the market price exceeding the strike price. The remaining options had no dilutive effect on earnings per share.

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.

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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, 2014			
(Dollar amounts in thousands)	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
U.S. government agency securities	$ -	$25,905	$ -	$25,905
Obligations of states and political subdivisions	-	88,359	-	88,359
Mortgage-backed securities in government- sponsored entities		37,444		37,444
Private-label mortgage-backed securities	-	3,476	-	3,476
Total debt securities	-	155,184	-	155,184
Equity securities in financial institutions	5	751	-	756
Total	$ 5	$155,935	$ -	$155,940

	December 31, 2013			
	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
U.S. government agency securities	$ -	$25,763	$ -	$25,763
Obligations of states and political subdivisions	-	88,614	-	88,614
Mortgage-backed securities in government- sponsored entities	-	38,323	-	38,323
Private-label mortgage-backed securities	-	3,693	-	3,693
Total debt securities	-	156,393	-	156,393
Equity securities in financial institutions	5	745	-	750
Total	$ 5	$157,138	$ -	$157,143

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

Financial instruments are considered Level III when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. In addition to these unobservable inputs, the valuation models for Level III financial instruments typically also rely on a number of inputs that are readily observable either directly or indirectly. Level III financial instruments also include those for which the determination of fair value requires significant management judgment or estimation. The Company has no securities considered to be Level III as of March 31, 2014 or December 31, 2013.

The Company uses prices compiled by third party vendors due to 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 III inputs, other real estate owned has been classified as Level III.

		March 31, 2014		
(Dollar amounts in thousands)	Level I	Level II	Level III	Total
Assets measured on a nonrecurring basis:				
Impaired loans	$ -	$-	$15,510	$15,510
Other real estate owned	-	-	2,656	2,656

		December 31, 2013		
	Level I	Level II	Level III	Total
Assets measured on a nonrecurring basis:				
Impaired loans	$ -	$-	$17,158	$17,158
Other real estate owned	-	-	2,698	2,698

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

	Quantitative Information about Level III Fair Value Measurements				
(Dollar amounts in thousands)	Fair Value Estimate		Valuation Techniques	Unobservable Input	Range (Weighted Average)
	March 31, 2014	December 31, 2013			
Impaired loans	$15,510	$ 17,158	Appraisal of collateral (1)	Appraisal adjustments (2)	0% to -55.0% (-27.3%)
Other real estate owned	$2,656	$ 2,698	Appraisal of collateral (1)	Appraisal adjustments (2)	0% to -10.0% (-7.5%)

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

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

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

	March 31, 2014				
	Carrying Value	Level I	Level II	Level III	Total Fair Value
	(Dollar amounts in thousands)				
Financial assets:					
Cash and cash equivalents	$42,810	$42,810	$-	$-	$42,810
Investment securities					
Available for sale	155,940	5	155,935	-	155,940
Net loans	436,714	-	-	447,832	447,832
Bank-owned life insurance	8,883	8,883		-	8,883
Federal Home Loan Bank stock	1,887	1,887		-	1,887
Accrued interest receivable	2,526	2,526	-	-	2,526
Financial liabilities:					
Deposits	$594,766	$404,762	$-	$178,074	$582,836
Short-term borrowings	5,320	5,320	-	-	5,320
Other borrowings	11,468	-	-	11,736	11,736
Accrued interest payable	345	345	-	-	345

	December 31, 2013				
	Carrying Value	Level I	Level II	Level III	Total Fair Value
	(Dollar amounts in thousands)				
Financial assets:					
Cash and cash equivalents	$26,193	$26,193	$-	$-	$26,193
Investment securities					
Available for sale	157,143	5	157,138	-	157,143
Net loans	428,679	-	-	430,502	430,502
Bank-owned life insurance	8,816	8,816	-	-	8,816
Federal Home Loan Bank stock	1,887	1,887	-	-	1,887
Accrued interest receivable	2,135	2,135	-	-	2,135
Financial liabilities:					
Deposits	$568,836	$394,422	$-	$175,854	$570,276
Short-term borrowings	10,809	10,809	-	-	10,809
Other borrowings	11,609	-		11,787	11,787

Accrued interest payable	364	364	-	-	364

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

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

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

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

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

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

The fair value is equal to the current carrying value.

Bank-Owned Life Insurance

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

Investment Securities Available for Sale

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

Net Loans

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

Deposits and Other Borrowings

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

Commitments to Extend Credit

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

NOTE 5 – ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table presents the changes in accumulated other comprehensive income (loss) by component net of tax for the three months ended March 31, 2014 and 2013:

	Unrealized gains on available for sale securities (a) (in thousands)
Balance as of December 31, 2013	$ (2,237)
Other comprehensive gain before reclassification	1,847
Amount reclassified from accumulated other comprehensive income (loss)	4
Total	1,851
Balance at March 31, 2014	$ (386)
Balance as of December 31, 2012	$ 5,391
Other comprehensive loss before reclassification	(1,004)
Amount reclassified from accumulated other comprehensive income (loss)	(122)
Period change	(1,126)
Balance at March 31, 2013	4,265

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

The following table presents significant amounts reclassified out of each component of accumulated other comprehensive income (loss):

(Dollar amounts in thousands)	Amount Reclassified from	Affected Line Item inthe Statement WhereNet Income is

Details about other comprehensive income (a)	Accumulated Other Comprehensive Income (Loss) For the Three Months Ended March 31, 2014	2013	Presented
Unrealized gains on available for sale securities			
	$ (6)	$ 185	Investment securities (losses) gains, net
	2	(63)	Income taxes
	$ (4)	$ 122	Net of tax

(a) Amounts in parentheses indicate debits to net income

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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, 2014 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	$26,938	$ 209	$ (1,242)	$25,905
Obligations of states and political subdivisions:				
Taxable	2,958	107	(4)	3,061
Tax-exempt	85,147	2,384	(2,233)	85,298
Mortgage-backed securities in government-sponsored entities	37,562	621	(739)	37,444
Private-label mortgage-backed securities	3,172	304	-	3,476
Total debt securities	155,777	3,625	(4,218)	155,184
Equity securities in financial institutions	750	6	-	756
Total	$156,527	$ 3,631	$ (4,218)	$155,940

	December 31, 2013 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	$27,289	$ 135	(1,661)	$25,763
Obligations of states and political subdivisions:				
Taxable	3,787	46	(38)	3,795
Tax-exempt	86,524	1,562	(3,267)	84,819
Mortgage-backed securities in government-sponsored entities	38,816	535	(1,028)	38,323
Private-label mortgage-backed securities	3,366	327	-	3,693
Total debt securities	159,782	2,605	(5,994)	156,393
Equity securities in financial institutions	750	-	-	750
Total	$160,532	$ 2,605	$ (5,994)	$157,143

The amortized cost and fair value of debt securities at March 31, 2014, 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	$ 1,052	$ 1,071
Due after one year through five years	4,318	4,512
Due after five years through ten years	22,888	22,995
Due after ten years	127,519	126,606
Total	$ 155,777	$ 155,184

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:

(Dollar amounts in thousands)	For the Three Months Ended March 31,	
	2014	2013
Proceeds from sales	$ 514	$ 7,438
Gross realized gains	-	204
Gross realized losses	(6)	(19)

Investment securities with an approximate carrying value of $65.8 million and $66.3 million at March 31, 2014 and December 31, 2013, respectively, were pledged to secure deposits and other purposes as required by law.

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

(Dollar amounts in thousands)	March 31, 2014 Less than Twelve Months Fair Value	Gross Unrealized Losses	Twelve Months or Greater Fair Value	Gross Unrealized Losses	Total Fair Value	Gross Unrealized Losses
U.S. government agency securities	$4,573	$ (247)	$12,738	$ (995)	$17,311	$ (1,242)
Obligations of states and political subdivisions	7,753	(561)	13,146	(1,676)	20,899	(2,237)
Mortgage-backed securities in government-sponsored entities	13,023	(399)	8,738	(340)	21,761	(739)
Total	$25,349	$ (1,207)	$34,622	$ (3,011)	$59,971	$ (4,218)

(Dollar amounts in thousands)	December 31, 2013 Less than Twelve Months Fair Value	Gross Unrealized Losses	Twelve Months or Greater Fair Value	Gross Unrealized Losses	Total Fair Value	Gross Unrealized Losses
U.S. government agency securities	$13,130	$ (929)	$7,166	$ (732)	$20,295	$ (1,661)
Obligations of states and political subdivisions						
Taxable	1,301	(38)	-	-	1,301	(38)
Tax-exempt	26,743	(2,883)	2,678	(383)	29,421	(3,267)
Mortgage-backed securities in government-sponsored entities	18,082	(757)	5,248	(271)	23,330	(1,028)
Total	$59,255	$ (4,608)	$15,092	$ (1,386)	$74,347	$ (5,994)

There were 75 securities considered temporarily impaired at March 31, 2014.

On a quarterly basis, the Company performs an assessment to determine whether there have been any events or economic circumstances indicating that a security with an unrealized loss has suffered other-than-temporary impairment (“OTTI”). A debt security is considered impaired if the fair value is less than its amortized cost basis at the reporting date. The Company assesses whether the unrealized loss is other than temporary.

OTTI losses are recognized in earnings when the Company has the intent to sell the debt security or it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost basis. However, even if the Company does not expect to sell a debt security, it must evaluate expected cash flows to be received and determine if a credit loss has occurred.

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

Debt securities issued by U.S. government agencies, U.S. government-sponsored enterprises, and state and political subdivisions accounted for more than 97% of the total available-for-sale portfolio as of March 31, 2014 and no credit losses are expected, given the explicit and implicit guarantees provided by the U.S. federal government and the lack of prolonged unrealized loss positions within the obligations of state and political subdivisions security portfolio. The Company's assessment was concentrated mainly on private-label collateralized mortgage obligations of approximately $3.2 million for which the Company evaluates credit losses on a quarterly basis. The gross unrealized gain position related to these private-label collateralized mortgage obligations amounted to $304,000 on March 31, 2014. The Company considered the following factors in determining whether a credit loss exists and the period over which the debt security is expected to recover:

- The length of time and the extent to which the fair value has been less than the amortized cost basis.
- Changes in the near term prospects of the underlying collateral of a security such as changes in default rates, loss severity given default and significant changes in prepayment assumptions;
- The level of cash flows generated from the underlying collateral supporting the principal and interest payments of the debt securities; and
- Any adverse change to the credit conditions and liquidity of the issuer, taking into consideration the latest information available about the overall financial condition of the issuer, credit ratings, recent legislation and government actions affecting the issuer's industry and actions taken by the issuer to deal with the present economic climate.

For the three months ended March 31, 2014 and 2013, there were no available-for-sale debt securities with an unrealized loss that suffered OTTI. Management does not believe any individual unrealized loss as of March 31, 2014 or December 31, 2013 represented an other-than-temporary impairment. The unrealized losses on debt securities are primarily the result of interest rate changes. These conditions will not prohibit the Company from receiving its contractual principal and interest payments on these debt securities. The fair value of these debt securities is expected to recover as payments are received on these securities and they approach maturity. 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.

NOTE 7 - LOANS AND RELATED ALLOWANCE FOR LOAN AND LEASE LOSSES

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

	March 31, 2014	December 31, 2013
Commercial and industrial	$56,855	$54,498
Real estate - construction	25,241	25,601
Real estate - mortgage:		
Residential	215,809	210,310
Commercial	140,543	141,171
Consumer installment	5,281	4,145
	443,729	435,725
Less Allowance for loan and lease losses	7,015	7,046
Net loans	$436,714	$428,679

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

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

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

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

March 31, 2014	Commercial and industrial	Real estate- construction	Real Estate- Mortgage Residential	Real Estate- Mortgage Commercial	Consumer installment	Total
Loans:						
Individually evaluated for impairment	$ 2,929	$ 3,695	$5,097	$ 5,153	$ 18	$16,892
Collectively evaluated for impairment	53,926	21,546	210,712	135,390	5,263	426,837
Total loans	$ 56,855	$ 25,241	$215,809	$ 140,543	$ 5,281	$443,729

December 31, 2013	Commercial and industrial	Real estate- construction	Real estate- Mortgage Residential	Real estate- Mortgage Commercial	Consumer installment	Total
Loans:						
Individually evaluated for impairment	$ 1,891	$ 4,011	$5,882	$ 7,175	$ 6	$18,965
Collectively evaluated for impairment	52,607	21,590	204,428	133,996	4,139	416,760
Total loans	$ 54,498	$ 25,601	$210,310	$ 141,171	$ 4,145	$435,725

March 31, 2014	Commercial and industrial	Real estate- construction	Real Estate- Mortgage Residential	Real Estate- Mortgage Commercial	Consumer installment	Total
Allowance for loan and lease losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 221	$ 153	$798	$ 198	$ 12	$1,382
Collectively evaluated for impairment	646	335	2,928	1,664	60	5,633
Total ending allowance balance	$ 867	$ 488	$3,726	$ 1,862	$ 72	$7,015

Real Estate-
Mortgage

December 31, 2013	Commercial and industrial	Real estate- construction	Residential	Commercial	Consumer installment	Total
Allowance for loan and lease losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 179	$ 210	$855	$ 563	$ -	$1,807
Collectively evaluated for impairment	435	366	2,809	1,607	22	5,239
Total ending allowance balance	$ 614	$ 576	$3,664	$ 2,170	$ 22	$7,046

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

Management evaluates individual loans in all of the commercial segments for possible impairment if the loan is greater than $200,000 and if the loan either is in nonaccrual status, or is risk rated Substandard and is greater than 90 days past due. Loans are considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. The Company does not separately evaluate individual consumer and residential mortgage loans for impairment, unless such loans are part of a larger relationship that is impaired.

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

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

March 31, 2014
Impaired Loans

	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial and industrial	$ 2,402	$ 2,402	$ -
Real estate - construction	3,058	3,058	-
Real estate - mortgage:			
Residential	2,670	2,783	-
Commercial	4,073	4,073	-
Consumer installment	11	11	-
Total	$ 12,214	$ 12,327	$ -
With an allowance recorded:			
Commercial and industrial	$ 527	$ 527	$ 221
Real estate - construction	637	637	153
Real estate - mortgage:			
Residential	2,427	2,466	798
Commercial	1,080	1,080	198
Consumer installment	7	7	12
Total	$ 4,678	$ 4,717	$ 1,382
Total:			
Commercial and industrial	$ 2,929	$ 2,929	$ 221
Real estate - construction	3,695	3,695	153
Real estate - mortgage:			
Residential	5,097	5,249	798
Commercial	5,153	5,153	198
Consumer installment	18	18	12

Total	$ 16,892	$ 17,044	$ 1,382

December 31, 2013
Impaired Loans

	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial and industrial	$ 1,357	$ 1,357	$ -
Real estate - construction	124	124	-
Real estate - mortgage:			
Residential	2,704	2,892	-
Commercial	5,093	5,093	-
Consumer installment	6	6	-
Total	$ 9,284	$ 9,472	$ -
With an allowance recorded:			
Commercial and industrial	$ 534	$ 534	$ 179
Real estate - construction	3,887	3,887	210
Real estate - mortgage:			
Residential	3,178	3,217	855
Commercial	2,082	2,082	563
Consumer installment	-	-	-
Total	$ 9,681	$ 9,720	$ 1,807
Total:			
Commercial and industrial	$ 1,891	$ 1,891	$ 179
Real estate - construction	4,011	4,011	210
Real estate - mortgage:			
Residential	5,882	6,109	855
Commercial	7,175	7,175	563
Consumer installment	6	6	-
Total	$ 18,965	$ 19,192	$ 1,807

The following tables present interest income by class, recognized on impaired loans (in thousands):

For the Three Months Ended

March 31, 2014

Average Interest

Recorded Income

	Investment	Recognized
Total:		
Commercial and industrial	$2,558	$ 37
Real estate - construction	3,719	41
Real estate - mortgage:		
Residential	5,239	