SUPERMEDIA INC.
Form DEF 14A
April 11, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant x

Filed by a Party other than the Registrant o

Check the appropriate box:

o	Preliminary Proxy Statement
o	**Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
x	Definitive Proxy Statement
o	Definitive Additional Materials
o	Soliciting Material Pursuant to §240.14a-12

SUPERMEDIA INC.
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x	No fee required.	
o	Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.	
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	(4)	Proposed maximum aggregate value of transaction:
	(5)	Total fee paid:
o	Fee paid previously with preliminary materials.	
o	Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.	
	(1)	Amount Previously Paid:
	(2)	Form, Schedule or Registration Statement No.:
	(3)	Filing Party:
	(4)	Date Filed:

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NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To be held on May 23, 2012

The 2012 annual meeting of stockholders of SuperMedia Inc. (the *company*) will be held on Wednesday, May 23, 2012, at 9:00 a.m., local time, at Dallas/Fort Worth Marriott Solana, 5 Village Circle, Westlake, Texas 76262. The meeting will be held for the following purposes:

1. To elect nine directors to serve until the 2013 annual meeting of stockholders;

2. To approve the company s executive compensation;

3. To ratify the appointment of Ernst & Young LLP as the company s independent registered public accounting firm for 2012; and

4. To transact such other business as may properly come before the meeting.

Information concerning the matters to be voted upon at the meeting is set forth in the accompanying proxy statement. Holders of record of the company s common stock as of the close of business on March 26, 2012, are entitled to notice of, and to vote at, the meeting.

The company is pleased to take advantage of the Securities and Exchange Commission rules that allow issuers to furnish proxy materials to their stockholders on the Internet. The company believes these rules allow us to provide you with the information you need while lowering the costs of delivery and reducing the environmental impact of the annual meeting. On or about April 11, 2012, we mailed a Notice of Internet Availability of Proxy Materials to our stockholders containing instructions on how to access the proxy statement and vote online and made proxy materials available to the stockholders over the Internet. Instructions for requesting a paper or e-mail copies of the proxy materials are contained in the Notice of Internet Availability of Proxy Materials.

You are cordially invited to attend the annual meeting in person. To ensure that your vote is counted at the annual meeting, however, please vote as promptly as possible.

By Order of the Board of Directors,

Cody Wilbanks
Executive Vice President,
General Counsel and Secretary

D/FW Airport, Texas

April 11, 2012

IMPORTANT

Whether or not you plan to attend the meeting in person, please vote over the internet at www.proxyvote.com promptly so that your shares may be voted in accordance with your wishes. If you request paper or e-mail copies of the proxy materials (which include a proxy card), you may also vote by completing, signing and returning the proxy card by mail.

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SUPERMEDIA INC.

P.O. Box 619810

2200 West Airfield Drive

D/FW Airport, Texas 75261

PROXY STATEMENT

GENERAL INFORMATION ABOUT THE ANNUAL MEETING AND VOTING

This proxy statement provides information in connection with the solicitation of proxies by the board of directors (the *board*) of SuperMedia Inc. (the *company*) for use at the company s 2012 annual meeting of stockholders or any postponement or adjournment thereof (the *annual meeting*). This proxy statement also provides information you will need in order to consider and to act upon the matters specified in the accompanying notice of annual meeting of stockholders.

Holders of record of the company s common stock as of the close of business on March 26, 2012, are entitled to vote at the annual meeting. Each holder of record as of March 26, 2012 is entitled to one vote for each share of common stock held. On March 26, 2012, there were 15,463,385 shares of common stock outstanding.

Pursuant to rules adopted by the Securities and Exchange Commission, the company has elected to provide access to its proxy materials via the Internet. Accordingly, on or about April 11, 2012, we mailed a Notice of Internet Availability of Proxy Materials (the notice) to all stockholders of record as of the close of business on March 26, 2012. This notice includes (i) instructions on how to access the company s proxy materials electronically, (ii) the date, time and location of the annual meeting, (iii) a description of the matters intended to be acted upon at the annual meeting, (iv) a list of the materials being made available electronically, (v) instructions on how a stockholder can request to receive paper or e-mail copies of the proxy materials, (vi) any control/identification numbers that a stockholder needs to access the proxy, and (vii) information about attending the annual meeting and voting in person. The company encourages stockholders to take advantage of the availability of the proxy materials on the Internet to help reduce the costs of delivery and the environmental impact of its annual meetings.

Most of our stockholders hold their shares through a broker, bank or other nominee rather than directly in their own name. As summarized below, there are some distinctions between shares held of record and those owned beneficially, in street name.

If your shares are registered directly in your name with the company s transfer agent, you are considered the stockholder of record with respect to those shares, and the notice is being sent directly to you by the company s agent. As a stockholder of record, you have the right to vote by proxy or to vote in person at the annual meeting. If you request paper or e-mail copies of the proxy materials, the materials will include a proxy card for the annual meeting.

If your shares are held in a brokerage account or by a bank or other nominee, you are considered the beneficial owner of shares held in street name, and the notice will be forwarded to you by your broker or nominee. The broker or nominee is considered the stockholder of record with respect to those shares. As the beneficial owner, you have the right to direct your broker how to vote. Beneficial owners that receive the notice by mail from their broker or nominee should follow the instructions included in the notice to view the proxy statement and transmit voting instructions. If you request paper or e-mail copies of the proxy materials, the proxy materials will include a proxy card for the annual meeting.

You cannot vote your shares unless you are present at the annual meeting or you have previously given your proxy. You can vote in one of four convenient ways:

- in person: if you are a stockholder of record, you may vote in person at the annual meeting; if you are a beneficial owner of shares held in street name and you wish to vote in person at the annual meeting, you must obtain a legal proxy from the organization that holds your shares (please contact that organization for instructions regarding obtaining a legal proxy);

- via the Internet: you may vote via the Internet by following the instructions provided in the notice;

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- by telephone: if you request paper or e-mail copies of the proxy materials, you may vote by calling the toll free number found on the proxy card; or

- by mail: if you request paper or e-mail copies of the proxy materials, you may vote by filling out the proxy card and sending it back in the envelope provided.

You may revoke your proxy at any time prior to the vote at the annual meeting by:

- voting again on a later date via the Internet or by telephone (in which case only your latest Internet or telephone proxy submitted prior to the annual meeting will be counted);

- delivering a written notice revoking your proxy to the company s corporate secretary at the address above;

- delivering a new proxy bearing a date after the date of the proxy being revoked; or

- voting in person at the annual meeting.

All properly executed proxies, unless revoked as described above, will be voted at the annual meeting in accordance with your directions on the proxy. With respect to the election of directors, you may vote for all nominees, withhold your vote for all nominees, or withhold your vote as to one or more specific nominees. If a properly executed proxy does not provide instructions, the shares of common stock represented by your proxy will be voted:

- FOR the election of the director nominees to serve until the company s 2013 annual meeting of stockholders;

- FOR the advisory vote approving of the company s executive compensation;

- FOR ratification of the appointment of Ernst & Young LLP as the company s independent registered public accounting firm for 2012; and

- at the discretion of the proxy holders with regard to any other matter that is properly presented at the annual meeting.

If you own shares of common stock held in street name and you do not instruct your broker how to vote your shares using the instructions your broker provides you, your shares will be voted in and for the ratification of the appointment of Ernst & Young LLP as the company s independent registered public accounting firm for 2012, but not with respect to any other proposal. To be sure your shares are voted in the manner you desire, you should instruct your broker how to vote your shares.

Voting your shares is important. Stock exchange rules prohibit your broker from voting your shares on Proposals 1 and 2 without your express voting instructions.

A majority of the outstanding shares of common stock must be present, in person or by proxy, to constitute a quorum at the annual meeting. The directors will be elected by a plurality of the votes cast by holders of the company s common stock. If you withhold authority to vote for a director nominee, your shares will not be counted in the vote for the director nominee. Approval of the advisory vote on executive compensation and ratification of Ernst & Young LLP as the company s independent registered public accounting firm for 2012 each require the affirmative vote of a majority of the shares present in person or represented by proxy and entitled to vote at the annual meeting. Those who fail to return a proxy or attend the annual meeting will not have their shares counted towards determining any required vote or quorum.

The company is soliciting your proxy and will pay the cost of such solicitation, including preparing this proxy statement and the proxy card and the costs of any mailing. The company may request banks, brokers and other custodians, nominees and fiduciaries to forward copies of these proxy materials to their principals and to request authority for the execution of proxies. The company may reimburse such persons for their expenses in so doing.

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PROPOSAL 1

ELECTION OF DIRECTORS

The company s by-laws provide that the number of directors will be determined by our board of directors from time to time, provided that the number of directors may not be less than seven nor more than eleven. After the annual meeting, the number of directors to serve on the board of directors will be set at nine directors.

Each of our current directors is serving a term that expires at the annual meeting. Each of the director nominees listed below is an incumbent director whose nomination to serve on the board was recommended by the nominating and corporate governance committee and approved by the board. The director nominees, if elected, will serve until the 2013 annual meeting of stockholders, or until their earlier resignation or removal. Each of the director nominees has indicated a willingness to serve as a director if elected.

The directors will be elected by a plurality of the votes cast at the annual meeting. An abstention or a withhold vote is not considered a vote cast and will have no effect on the outcome of the election of directors.

The board recommends a vote FOR each of the nine director nominees listed below.

Edward J. Bayone, age 57, has served as a director of the company since December 31, 2009. He also serves as a member of the audit committee. He has taught full time at Brandeis University s International Business School since 2003 and is the Earle W. Kazis Professor of the Practice of Finance and International Real Estate. He previously served as an advisor to Churchill Financial, LLC, a commercial finance and asset management company founded by Bear Stearns Merchant Banking (now known as Irving Place Capital) from July 2009 to June 2010 and served as a board member from 2006 to 2009. Mr. Bayone was formerly a financial consultant to various corporate clients from 2003 to 2006. Prior to this, he held numerous positions at FleetBoston Financial Group, and its predecessors, from 1979 to 2002, including executive vice president and chief credit officer. Mr. Bayone has an M.I.A. in Banking and Finance from Columbia University, an M.A. in History from the University of Rochester, and a B.A. in History from Queens College. He is also a member of the board of the Combined Jewish Philanthropies of Greater Boston and serves on the Budget and Administration Committee.

Mr. Bayone possesses a strong financial management background, as evidenced by the various financial management, teaching and consulting positions held during his career. Mr. Bayone s experience and training in financial credit management provide a solid background for him to advise and consult with the board on financial and audit-related matters as a member of the audit committee.

Robert C. Blattberg, age 69, has served as a director of the company since December 31, 2009. He also serves as chairman of the nominating and corporate governance committee. He is currently the Timothy W. McGuire Distinguished Service Professor of Marketing and the director of the Center for Marketing Technology and Information at Carnegie Mellon University s Tepper School of Business. From 1991 to 2008, Mr. Blattberg was a professor and director of the Center for Retail Management at Northwestern University s Kellogg Graduate School of Management. Prior to this, he was a professor and director of the Center for Marketing Information Technology at the University of Chicago Graduate School of Business. Mr. Blattberg has a Ph.D. and an M.S. in Industrial Administration from Carnegie-Mellon University and a B.A. in Mathematics from Northwestern University. He has received numerous research grants from various organizations and has also been honored with a number of awards, including Best Paper in 2005 from the Journal of Interactive Marketing, Educator of the Year in 2004 from the Sales and Marketing Executives organization, and the Robert B. Clarke Award as the Direct Marketing Association Educator of the Year in 1990. Mr. Blattberg has also authored and published a wide array of books, industry reports and articles focused on various topics in marketing and economics.

Mr. Blattberg s extensive marketing and retail management experience provides the board with a valuable perspective on the yellow pages and advertising industries. Mr. Blattberg also brings to us experience from having recently served on another public company board of directors, which allows us to benefit from his insight into current trends in public company governance.

Charles B. Carden, age 67, has served as a director of the company since December 31, 2009. He also serves as chairman of the audit committee. Mr. Carden previously served as a director and member of the audit and compensation committees for Goldleaf Financial Solutions, a publicly-held financial software and services company, which was acquired by Jack Henry and Associates in October 2009, and as a director and member of the compensation committee for Netzee Inc., a publicly-held provider of Internet banking and bill payment services that was acquired by Certegy, Inc. in 2002. He also previously served on the board of directors of Ivox Corp., a privately held software company that provides driver-based risk management information to fleets and insurance companies. He also served on the advisory board of Dialog Medical, a privately held software company. From 1999 to 2007, Mr. Carden held the positions of senior vice president and chief financial officer for John H. Harland Company, a provider of products and services to the financial institution and education markets. Prior to this, he was the executive vice president and chief financial officer for Mariner Post-Acute Network and the senior vice president, finance and administration and chief financial officer for Leaseway Transportation Corp. In addition, he has served as a director of Fairmont Theatre for the Deaf and the Bellflower Center for the Prevention of Child Abuse. Mr. Carden has an M.B.A. from Harvard University and a B.A. in Mathematics from Westminster College. He also served as a lieutenant in the U.S. Army in Vietnam.

Mr. Carden s significant experience in senior financial positions at various companies provides a solid background for him to advise and consult the board on financial and audit-related matters as chairman of the audit committee and to serve as the audit committee s designated financial expert. Additionally, his previous service on public company boards provides valuable insight into working with directors generally and the appropriate exercise of diligence and oversight.

Thomas D. Gardner, age 54, has served as a director of the company since December 31, 2009. He also serves on the audit committee and the compensation committee. He is a trustee for Guideposts, and previously served as a trustee for Northern Westchester Hospital and Reader s Digest Foundation. He served as executive vice president of Reader s Digest Association, Inc. from 2006 to 2007, and was president of Reader s Digest International from 2003 to 2007. Prior to holding those positions, he held numerous other positions with Reader s Digest Association, Inc. from 1992 to 2007, including president, North American Books and Home Entertainment; senior vice president, global marketing; senior vice president, corporate strategy and U.S. new business development; vice president, marketing, Reader s Digest USA; and director, corporate planning. From 1989 to 1992, Mr. Gardner was a management consultant for McKinsey & Co. Other experience includes time with General Foods Corporation in product management, desserts division, and with Yankelovich, Skelly and White, Inc., industrial and corporate communications division, in project management. Mr. Gardner has an M.B.A. from Stanford University and a B.A. in Political Science from Williams College.

Mr. Gardner s significant experience in the publishing industries, including his several senior positions at Reader s Digest, gives him an in-depth understanding of the opportunities and challenges associated with our business. In addition, Mr. Gardner brings an understanding of financial issues to the board and the audit committee.

David E. Hawthorne, age 61, has served as a director of the company since December 31, 2009. He also serves as chairman of the compensation committee. He has been with Hawthorne Management LLC since 2005, a firm that develops, owns and operates commercial real estate in central Florida. He previously served as a consultant to Friedman s Inc., assisting the jewelry retailer in investigating operating and financial issues. From 2001 to 2003, Mr. Hawthorne was the president and chief executive officer of Lodgian, Inc., one of the largest independent hotel owners and operators. In December 2001, Lodgian filed for voluntary reorganization under Chapter 11 of the U.S. Bankruptcy Code. Mr. Hawthorne was a consultant for FTI Consulting, Inc. from 2000 to 2001, during which he served as executive vice president and chief restructuring officer of Tower Records, Inc. Mr. Hawthorne has also served as the acting chief executive officer of Premier Cruise Lines, the executive vice president and chief financial officer of Alliance Entertainment Corporation, and the chairman and chief executive officer of Servico Hotels and Resorts, Inc. Mr. Hawthorne has an M.B.A. from the University of Tampa and a B.A. from the University of South Florida. In addition, he served in the U.S. Army from 1970 to 1972.

Mr. Hawthorne s significant experience in senior and executive positions at various companies provides a solid platform for him to advise the company and enhances the board s business sophistication. Additionally, his experience, including his position as executive vice president and chief restructuring officer of Tower Records, Inc., is of substantial importance to the board in addressing similar aspects of the company s business.

Peter J. McDonald, age 61, has been the company s president and chief executive officer and has served as a director of the company since December 2010. From October 4, 2010 until December 9, 2010, Mr. McDonald served as the company s interim chief executive officer. Prior to joining the company, Mr. McDonald held various positions at R.H. Donnelley Corporation (now known as Dex One Corporation), including as president and chief operating officer from 2004 through 2008. In May 2009, R.H. Donnelley filed for voluntary reorganization under Chapter 11 of the U.S. Bankruptcy Code. From 2002 to 2008, Mr. McDonald served as senior vice president and president of Donnelley Media. Mr. McDonald served as a director of R.H. Donnelley between 2001 and 2002. Previously, Mr. McDonald served as president and chief executive officer of SBC Directory Operations, a publisher of yellow pages directories, from 1999 to 2000. He was president and chief executive officer of Ameritech Publishing s yellow pages business from 1994 to 1999, when Ameritech was acquired by SBC. Prior to that, Mr. McDonald was president and chief executive officer of DonTech and served in a variety of sales positions at R.H. Donnelley, after beginning his career at National Telephone Directory Corporation. He is currently the chairman of Local Search Association, formerly known as the Yellow Pages Publishers Association, where he previously served as vice chairman.

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Mr. McDonald s over 35 years of experience in the yellow pages directory advertising and publication industry gives him in-depth knowledge of the opportunities and challenges associated with our business. Mr. McDonald s familiarity with our business and industry and the various market participants provides invaluable insight and advice to our board.

Thomas S. Rogers, age 57, has served as a director of the company since 2006 and as vice chairman of the board since July 2010. He also serves as a member of the compensation committee and the nominating and corporate governance committee. Mr. Rogers currently serves as president and chief executive officer of TiVo Inc., a provider of television-based interactive and entertainment services, a position he has held since July 2005. He also currently serves on the board of directors of TiVo Inc. Mr. Rogers previously served as chairman of the board of Teleglobe International Holdings, Ltd., a provider of international voice, data, Internet and mobile roaming services, from November 2004 to February 2006. He also has served as chairman of TRget Media LLC, a media industry investment and operations advisory firm, since July 2003. Mr. Rogers served as the senior operating executive for media and entertainment for Cerberus Capital Management, a large private equity firm, from 2004 to July 2005. Prior to holding that position, he served as chairman and chief executive officer of Primedia, Inc., a print, video and online media company, from October 1999 to April 2003. From January 1987 until October 1999, Mr. Rogers held positions with National Broadcast Company, Inc., including president of NBC Cable and executive vice president.

As a long-term member of the board, Mr. Rogers has a familiarity with the company that makes him uniquely qualified to serve as a director of the company. As president and chief executive officer of a public company, Mr. Rogers has significant exposure to, and we benefit from his experiences related to, the opportunities and challenges associated with our business. Additionally, his service on other public company boards allows us to leverage his experiences with, among other things, appropriate oversight and corporate governance matters.

John Slater, age 38, has served as a director of the company since January 21, 2010. He currently serves as a vice president at Paulson & Co. Inc. where he focuses on investments in the media, telecom and technology sectors. Mr. Slater joined Paulson in January 2009. Previously, he was a vice president at Lehman Brothers and Barclays Capital where he worked from 2004 to 2008 in the global trading strategies group focusing on investments in the media and other sectors. Prior to Lehman, he was senior director, finance and strategy at NextSet Software Inc., a financial trading systems software vendor. He started his career as an associate consultant at Burlington Consultants, a strategy consultancy based in London. He holds an M.B.A. from INSEAD, an M.A. and B.A. from the University of Cambridge and he is a CFA Charterholder.

Mr. Slater brings leadership, financial experience and a background in the media, telecom and technology industries to the board. Mr. Slater s exposure to companies in the media, telecom and technology industries provides valuable insight to the board regarding industry trends that affect our company.

Douglas D. Wheat, age 61, has served as chairman of the board since July 2010. From October 2010 to December 2010 he served as executive chairman. He currently serves as chairman of AMN Healthcare Services, Inc., one of the leading temporary healthcare staffing companies in the world. Mr. Wheat previously served as a director of Playtex Products, Inc. from 1995 to 2007 (including serving as its chairman from 2004 to 2006). Mr. Wheat has served as a member of the boards of directors of Dr. Pepper/Seven-Up Companies, Inc., Thermadyne Industries, Inc., Sybron International Corporation, Smarte Carte Corporation, Nebraska Book Corporation, and ALC Communications Corporation. Since 2008, he has served as managing Partner of Southlake Equity Group (formerly Challenger Equity Group), a private investment firm. Prior to Southlake Equity Group, he served as president of Haas Wheat & Partners, a private investment firm specializing in strategic equity investments and leveraged buyouts of middle market companies from 1992 to 2006. Mr. Wheat also held various leadership and senior management positions at Grauer & Wheat and Donaldson Lufkin & Jenrette Securities Corporation earlier in his career.

Mr. Wheat s extensive experience serving on public company boards, including as chairman, and his expertise in a variety of financial matters make him highly qualified to lead and advise our board as chairman. Additionally, Mr. Wheat s experiences have provided him with critical knowledge with respect to, among other things, appropriate oversight and related actions utilized in the board environment, including concerning corporate governance matters.

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PROPOSAL 2

ADVISORY RESOLUTION TO APPROVE EXECUTIVE COMPENSATION

Following emergence from Chapter 11 reorganization, the compensation committee undertook a detailed review of our executive compensation programs. As a result of this effort, we better aligned the interests of our leadership with our stockholders, which supports our dedicated efforts to significantly reduce operating costs in an effort to help mitigate declines in revenue.

At the company s annual meeting of stockholders held in May 2011, a substantial majority (92.3%) of the votes cast on the proposal to approve executive compensation, on an advisory basis, were voted in favor of the proposal. The compensation committee believes this affirms stockholders support of the company s approach to executive compensation.

Our goal for the company s executive compensation program is to attract, motivate, and retain a talented, entrepreneurial and creative team of executives who will provide leadership for the company s success in dynamic and competitive markets. We seek to accomplish this goal in a way that rewards performance and is aligned with our stockholders long-term interests. This is discussed in detail in the Compensation Discussion and Analysis and accompanying tables. Recipients of our 2011 long-term incentive plan equity grants participated along with other stockholders in the rise and fall of the company s share price during the year. Because the value of stock-based awards rises and falls with our stock price, we believe that the 2011 long-term incentive awards provide an effective link between executive pay and long term stockholders interests.

We believe stockholders should consider the following key components of our compensation programs and governance practices when voting on this proposal:

- Pay for performance orientation: our executive compensation program includes a mix of fixed and variable compensation, including base salaries, annual and long-term incentives that create a balance between short-term and long-term focus; incentive compensation of executive officers is based on a balanced mix of performance measures, including revenue, profitability and total stockholder return.

- Alignment with long-term stockholder interests: our option awards and time-vested restricted stock awards have multi-year vesting, and performance awards are based on achievement of financial and operational goals over a pre-determined period. The value of these awards is directly linked to our stock price, aligning the financial interests of our executives with the interests of our stockholders.

This advisory stockholder vote, commonly known as say-on-pay, gives you, as a stockholder, the opportunity to endorse or not endorse our executive compensation program by voting for or against the following resolution:

RESOLVED, that the stockholders approve the compensation of the company s named executive officers, as disclosed pursuant to the compensation disclosure rules of the Securities and Exchange Commission, including the Compensation Discussion and Analysis, compensation tables and any related material disclosed in this proxy statement.

Your consideration of this resolution is required pursuant to Section 14A of the Securities Exchange Act of 1934, as amended. In view of the fact that this vote is advisory, it will not be binding on the company or the board. However, the compensation committee will take into account the outcome of the vote when considering future executive compensation arrangements.

The affirmative vote of a majority of the shares present in person or represented by proxy and entitled to vote at the annual meeting is required to adopt the resolution approving the company s executive compensation program. Abstentions will be counted toward a quorum and considered shares present in person or by proxy and entitled to vote. Accordingly, abstentions will have the effect of a vote against this proposal.

We intend to hold this stockholder advisory vote to approve executive compensation annually until we hold the next advisory vote on the frequency of stockholder advisory votes on executive compensation, as required pursuant to Section 14A of the Securities Exchange Act of 1934, as amended.

The board recommends a vote FOR proposal 2.

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PROPOSAL 3

RATIFICATION OF APPOINTMENT OF

ERNST & YOUNG LLP AS THE COMPANY S INDEPENDENT

REGISTERED PUBLIC ACCOUNTING FIRM FOR 2012

The audit committee has appointed Ernst & Young LLP as the company s independent registered public accounting firm for 2012. The board is asking stockholders to ratify this appointment. Although Securities and Exchange Commission regulations require the company s independent registered public accounting firm to be engaged, retained and supervised by the audit committee, the board considers the selection of an independent registered public accounting firm to be an important matter to stockholders and considers a proposal for stockholders to ratify such appointment to be an opportunity for stockholders to provide input to the audit committee and the board on a key corporate governance issue. In the event that our stockholders do not ratify the appointment, it will be considered as a direction to our audit committee to consider the selection of a different firm.

The affirmative vote of a majority of the shares present in person or represented by proxy and entitled to vote at the annual meeting is required to ratify the appointment of Ernst & Young LLP. Abstentions will be counted toward a quorum and considered shares present in person or by proxy and entitled to vote. Accordingly, abstentions will have the effect of a vote against this proposal.

Representatives of Ernst & Young LLP are expected to be present at the annual meeting and will be offered the opportunity to make a statement if they so desire. They will also be available to answer questions.

The board recommends a vote FOR proposal 3.

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CORPORATE GOVERNANCE

Corporate Governance Guidelines

The company is committed to maintaining the highest standards of business conduct and corporate governance, which we believe are essential to running our business efficiently, serving our stockholders well and maintaining our integrity in the marketplace. The company has adopted corporate governance guidelines and a code of conduct for directors, officers and employees, which, together with our certificate of incorporation, by-laws and board committee charters, form our framework for governance. All of these documents are publicly available on our website at *www.supermedia.com* or may be obtained free of charge upon written request to: SuperMedia Inc., P.O. Box 619810, 2200 West Airfield Drive, D/FW Airport, Texas 75261, Attention: Investor Relations.

Director Independence

As part of the company s corporate governance guidelines, the board has established a policy requiring a majority of the members of the board to be independent. Eight of our directors who are standing for re-election are independent (as defined by our corporate governance guidelines). For a director to be independent, the board must determine, among other things, that the director does not have a relationship with the company that interferes with the exercise of independent judgment in carrying out the duties of a director. The guidelines for determining director independence are set forth in our corporate governance guidelines, which conform to the independence requirements of the NASDAQ corporate governance standards and the applicable rules of the Securities and Exchange Commission. Applying these independence standards, the board has determined that Edward J. Bayone, Robert C. Blattberg, Charles B. Carden, Thomas D. Gardner, David E. Hawthorne, Thomas S. Rogers, John Slater and Douglas D. Wheat are independent directors. Peter J. McDonald is not independent because he is an employee of the company.

Director Nominations

Qualifications. In considering nominees for election as director, the nominating and corporate governance committee considers a number of factors, with an objective of having a board with diverse backgrounds and experience. In furtherance of this objective, although we do not have a formal diversity policy in place, an important factor in the nominating and corporate governance committee s consideration and assessment of a director candidate is the diversity of the candidate s background, viewpoints, training, professional experience, education and skill set. Characteristics expected of all directors include integrity, high personal and professional ethics, sound business judgment and the ability and willingness to commit sufficient time to the board. In evaluating the suitability of individual board members, the committee takes into account many factors, including the candidate s general understanding of marketing, finance and other disciplines relevant to the success of a large publicly traded company in today s business environment, understanding of the company s business and technology, educational and professional background and personal accomplishments.

Stockholder Recommendations. The nominating and corporate governance committee will evaluate any director candidates recommended by a stockholder according to the same criteria as a candidate identified by the nominating and corporate governance committee. The company has never received a recommendation for a director candidate from our stockholders in a manner that purported to comply with the procedures set forth in our by-laws.

Stockholders may recommend candidates at any time, but to be considered by the nominating and corporate governance committee for inclusion in the company s proxy statement for the next annual meeting of stockholders, recommendations must be submitted in writing no later than 120 days in advance of the first anniversary of the date of the company s proxy statement mailed to stockholders for the preceding year s annual meeting of stockholders. A stockholder s notice must contain the following:

- the name and address of the stockholder recommending the director candidate for consideration, the name of the director candidate and the written consent of the stockholder and the director candidate to be publicly identified;

- a written statement by the director candidate agreeing to be named in the company s proxy materials and to serve as a member of the board (and any committee of the board to which the director candidate is assigned to serve by the board) if nominated and elected;

- a written statement by the stockholder and director candidate agreeing to make available to the nominating and corporate governance committee all information reasonably requested in connection with the nominating and corporate governance committee s consideration of the director candidate; and

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- the director candidate s name, age, business and residential address, principal occupation or employment, number of shares of the company s common stock and other securities beneficially owned, a resume or similar document detailing personal and professional experiences and accomplishments, and all other information relating to the director candidate that would be required to be disclosed in a proxy statement or other filing made in connection with the solicitation of proxies for the election of directors pursuant to the Securities Exchange Act of 1934, as amended, the rules of the Securities and Exchange Commission and the NASDAQ corporate governance standards.

The stockholder s notice must be signed by the stockholder recommending the director candidate for consideration and sent to the following address: SuperMedia Inc., P.O. Box 619810, 2200 West Airfield Drive, D/FW Airport, TX 75261, Attention: Corporate Secretary (Nominating and Corporate Governance Committee Communication/Director Candidate Recommendation).

Communications with the Board

Any stockholder and other interested party may communicate with the board, any board committee, the non-management directors or any other individual director. All written communications must identify the recipient and the author and be forwarded by certified mail to: SuperMedia Inc., P.O. Box 619810, 2200 West Airfield Drive, D/FW Airport, TX 75261, Attention: Corporate Secretary. The corporate secretary will act as agent for the directors in facilitating these communications.

Code of Conduct

The company has adopted a code of conduct applicable to all of its directors, officers and employees, including the chief executive officer, chief financial officer and chief accounting officer. The purpose of the code of conduct is to, among other things, focus our directors, officers and employees on areas of ethical risk, provide guidance to help them recognize and deal with ethical issues, provide mechanisms to report unethical or unlawful conduct and to help enhance and formalize our culture of integrity, respect and accountability. The code of conduct is publicly available on our website at *www.supermedia.com* in the Investor Relations section and we will post information regarding any amendment to, or waiver from, the code of conduct on our website, as required by applicable law.

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THE BOARD, ITS COMMITTEES AND ITS COMPENSATION

The Board

Under the company s corporate governance guidelines, each director is expected to devote the time necessary to appropriately discharge his or her responsibilities, review all meeting materials distributed in advance of a meeting and be prepared to discuss the business to be presented and is strongly encouraged to attend and participate in all board meetings and meetings of board committees on which he or she serves. During 2011, the board held nine meetings. Each director attended at least 75% of the total number of meetings of the board and committees on which he or she served during the period he or she was a director.

The company s corporate governance guidelines and code of conduct both state that the directors are encouraged to attend each stockholder meeting. All of our directors attended the May 2011 annual stockholders meeting.

Board Leadership Structure and Risk Oversight

The chairman of the board provides leadership to the board and works with the board to define its structure and activities in the fulfillment of its responsibilities. Pursuant to the company s by-laws, the board may, at its discretion, elect a chairman of the board from among the directors who are not members of management, or who are serving as members of management on an interim basis at the request of the board. The board adopted this structure to promote decision-making and governance independent of that of our management and to better perform the board s monitoring and evaluation functions.

The board has established a policy that its non-management directors meet regularly in executive session, without members of management present. A non-management director presides over each executive session. In 2011, our chairman of the board or, in his absence, the vice chairman, had this responsibility.

We believe that the foregoing structure, policies and practices, when combined with the company s other governance policies and procedures, provide the best opportunities for oversight, discussion and evaluation of decisions and direction from the board.

The board views risk management as one of its primary responsibilities. A fundamental part of risk management is not only understanding the risks the company faces and what steps management is taking to manage those risks, but also understanding what level of risk is appropriate for the company. Therefore, the board reviews with management its process for managing enterprise risk. While the board maintains the ultimate oversight responsibility for risk management, it monitors risks arising from financial reporting and steps management is taking to monitor and control such potential exposures through the audit committee. The audit committee also discusses guidelines and policies to govern the process by which risk assessment and management is undertaken.

In 2011, the compensation committee engaged Mercer (USA) Inc. (Mercer) to conduct a risk assessment of the company s compensation policies and practices. This review included an analysis of the company s short- and long-term compensation programs across the company. Program elements assessed relating to compensation risks included, performance measures, funding, pay mix, performance period, goal setting and plan leverage and process and controls.

Based on its review, Mercer concluded that the company does not utilize compensation policies or practices that create risk that are reasonably likely to have a material adverse effect on the company. In reaching this conclusion, Mercer noted that:

- the company s short-term and long-term incentive plan opportunities are market based;
- compensation of executive officers is based on a balanced mix of performance measures, including revenue, profitability and total stockholder return;
- the board has direct oversight in approving short-term funding levels and long-term grants including the financial results which drive funding levels;
- incentive plan designs provide caps on payouts, and have pay for performance relationships consistent with typical compensation practices; and
- sales incentive programs offered by the company are governed by a cross-functional team, including sales management, human resources, finance and operations.

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The results of this review were shared with the compensation committee. While risk is inherent in any strategy for growth, based on the results of Mercer s review, the compensation committee concluded that the company s compensation programs are not reasonably likely to have a material adverse effect on the company as a whole.

Board Committees

The board has three standing committees: audit committee, compensation committee and nominating and corporate governance committee, each of which is described below. Each committee operates under a written charter adopted by the board. All of the charters are publicly available on our website at *www.supermedia.com* in the Investor Relations section. You may also obtain a copy of the charters upon written request to our investor relations department at our principal corporate headquarters.

Based upon the recommendations of the nominating and corporate governance committee, the board appoints committee members annually. The table below sets forth the current composition of our board committees.

	Audit Committee	**Compensation Committee**	**Nominating and Corporate Governance Committee**
Edward J. Bayone	ü		
Robert C. Blattberg			ü(Chair)
Charles B. Carden	ü(Chair)		
Robin Domeniconi			ü
Thomas D. Gardner	ü	ü	
David E. Hawthorne		ü(Chair)	
Thomas S. Rogers		ü	ü

Subject to directors re-election at the annual meeting, the composition of the board committees for 2012 will be as follows:

	Audit Committee	**Compensation Committee**	**Nominating and Corporate Governance Committee**
Edward J. Bayone	ü		ü(Chair)
Robert C. Blattberg		ü	ü
Charles B. Carden	ü(Chair)		
Thomas D. Gardner	ü	ü(Chair)	
David E. Hawthorne	ü		
Thomas S. Rogers		ü	ü

Audit Committee

The audit committee oversees our accounting and financial reporting processes and the audits of the company s financial statements. The functions and responsibilities of the audit committee include:

- establishing, monitoring and assessing the company s policies and procedures with respect to business practices, including the adequacy of the company s internal controls over accounting and financial reporting;
- reviewing the annual audited financial statements, the form of audit opinion and quarterly financial statements with management and the company s independent registered public accounting firm;
- reviewing with management, the independent registered public accounting firm and the internal auditors the scope and the planning of the annual audit;

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- engaging the company s independent registered public accounting firm and conducting an annual review of the independence of that firm;
- pre-approving all audit and permitted non-audit services to be performed by the company s independent registered public accounting firm;
- reviewing the findings and recommendations of the company s independent registered public accounting firm and management s response to the recommendations of that firm;
- overseeing the internal audit function;
- overseeing compliance with applicable legal and regulatory requirements;
- overseeing compliance with the company s code of conduct;
- establishing procedures for the receipt, retention and treatment of complaints received by the company regarding accounting, internal accounting controls or auditing matters;
- establishing procedures for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters;
- preparing the Audit Committee Report to be included in our annual proxy statement; and
- reviewing and reassessing the adequacy of the audit committee charter on an annual basis.

The audit committee may designate one or more subcommittees, each subcommittee to consist solely of independent directors, and the committee may delegate to such subcommittees any of its responsibilities, along with the authority to take action in relation to such responsibilities.

During 2011, the audit committee held eight meetings. Our independent registered public accounting firm reports directly to the audit committee. Each member of the audit committee has the ability to read and understand fundamental financial statements. The board has determined each member of the audit committee is independent as defined by the NASDAQ corporate governance standards and Rule 10A-3 of the Securities Exchange Act of 1934. The board has also determined that Mr. Carden meets the requirements of an audit committee financial expert as defined by the rules of the Securities and Exchange Commission.

Compensation Committee

The compensation committee establishes, administers and reviews the company s policies, programs and procedures for compensating our executive officers and the board. The functions and responsibilities of the compensation committee include:

- evaluating the performance of and determining the compensation for the company s executive officers, including its chief executive officer;
- administering and making recommendations to the board with respect to the company s equity incentive plan;
- approving, or recommending to the board for approval, and overseeing the execution of compensation and benefit plans for retirees;
- reviewing and approving employment and other contracts relating to compensation with the company s executive officers;
- reviewing director compensation policies, objectives and programs and approving, or recommending to the board for approval, the form and amount of director compensation;
- preparing the Compensation Committee Report to be included in the annual reports or proxy statement;

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- overseeing all matters relating to the stockholder approval of executive compensation;
- overseeing preparation of the Compensation Discussion and Analysis to be included in the annual report or proxy statement; and
- reviewing the adequacy of the compensation committee charter on an annual basis.

The compensation committee may designate one or more subcommittees, each subcommittee to consist solely of independent directors, and the committee may delegate to such subcommittees any of its responsibilities, along with the authority to take action in relation to such responsibilities.

During 2011, the compensation committee held 12 meetings. The board has determined that each member of the compensation committee is independent as defined by the NASDAQ corporate governance standards. The compensation committee engaged Mercer to advise it in its work. See further discussion in the Compensation Discussion and Analysis.

Nominating and Corporate Governance Committee

The functions and responsibilities of the nominating and corporate governance committee include:

- developing and recommending corporate governance guidelines applicable to the board and the company s employees;
- developing criteria and qualifications for directors to be used in identifying, reviewing and selecting director candidates;
- identifying individuals qualified to become directors and considering nominations of director candidates validly made by stockholders;
- recommending director nominees;
- recommending committee composition and assignments;

- overseeing and making recommendations with respect to the development of an effective compliance and ethics program;
- reviewing and assessing the adequacy of the company s code of conduct; and
- reviewing the adequacy of the nominating and corporate governance committee charter on an annual basis.

The nominating and corporate governance committee may designate one or more subcommittees, each subcommittee to consist solely of independent directors, and the committee may delegate to such subcommittees any of its responsibilities, along with the authority to take action in relation to such responsibilities.

During 2011, the nominating and corporate governance committee held three meetings. The board has determined that each member of the nominating and corporate governance committee is independent as defined by the NASDAQ corporate governance standards.

2011 Director Compensation

Set forth below is a summary of the components of compensation payable to non-management directors, except Mr. Slater, who has waived all director compensation, for board and committee services.

Cash Compensation. The annual cash retainer for board service is $70,000. The company reimburses directors for all expenses incurred in attending board and committee meetings. The table below shows director fees payable in addition to the annual retainer for 2011.

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Service	Fee Amount ($)
Annual Chairman of the Board Fee	70,000
Annual Vice Chairman of the Board Fee	10,000
Annual Audit Committee Chairman Fee	20,000
Annual Compensation Committee Chairman Fee	10,000
Annual Nominating and Corporate Governance Committee Chairman Fee	10,000
Per Board Meeting Fee(1)	1,500
Per Board Committee Meeting Fee	1,500

(1) Board meeting fees are paid only for meetings in addition to the regularly scheduled Board meetings.

Effective as of February 16, 2012, upon the recommendation of the compensation committee, the board approved an increase in: (i) the annual chairman of the board fee to $109,500; (ii) the annual compensation committee chairman fee to $20,000; (iii) per board meeting fee (other than the regularly scheduled board meetings) to $2,000; and (iv) per board committee meeting fee to $2,000.

Annual Equity-Based Compensation. Non-management directors, except Mr. Slater, generally receive an annual award of restricted stock equal to $70,000 divided by the closing price of our common stock on the grant date. Non-management directors who are first elected or appointed to the board other than at an annual meeting of stockholders receive a prorated award. In either case, the shares of restricted stock vest one year from the date of grant.

On February 24, 2012, in lieu of an annual restricted stock award equal to $70,000, the board granted each non-management director 5,000 shares of restricted stock, with the balance of the award to be payable in cash. The shares of restricted stock granted on February 24, 2012 will vest, and the balance of the award will be paid out in cash, one year from the date of grant.

Emergence Compensation. Non-management directors who joined the board on December 31, 2009, (except Mr. Slater) received a one-time award of restricted stock units valued at $50,000 to provide a significant equity stake in the company upon initiation of board service and to ensure that the interests of all new directors were aligned with the interests of the company s stockholders. These one-time awards vest in three equal annual installments beginning on the first anniversary of the grant date. If a director ceases to be a member of the board on or before the third anniversary date of the award, the restricted stock units will vest on a prorated basis by dividing the number of days commencing on the most recent vesting date, and ending on the date of separation from service. The restricted stock units settle upon a director s departure from the board in good standing.

Director Compensation Table. The table below sets forth the compensation paid to our non-management directors for service during 2011.

Name(1)	Fees Earned or Paid in Cash	Stock Awards(2)	Total
Edward J. Bayone	$ 91,242	$ 70,000	$ 161,242
Robert C. Blattberg	89,000	70,000	159,000
Charles B. Carden	112,425	70,000	182,425
Robin Domeniconi	79,000	70,000	149,000

Thomas D. Gardner	111,850	70,000	181,850
David E. Hawthorne	105,425	70,000	175,425
Thomas S. Rogers	108,425	70,000	178,425
John Slater(3)			
Douglas D. Wheat	$ 146,000	$ 70,000	$ 216,000

(1) Peter J. McDonald, our president and chief executive officer, is not included in this table because he was an employee of the company during 2011 and, therefore, did not receive compensation for his service as a director. See Executive Compensation Summary Compensation Table for a discussion of the compensation earned by Mr. McDonald during 2011.

(2) Represents the aggregate grant date fair value of restricted stock granted to our non-management directors in 2011. Pursuant to the Securities and Exchange Commission rules, the dollar amounts were computed in accordance with Financial Accounting Standards Board Accounting Standards Codification Topic 718, Compensation-Stock Compensation (*ASC Topic 718*), and exclude the impact of estimated forfeitures related to service-based vesting

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conditions. See note 12 to the consolidated financial statements in the company s annual report on Form 10-K for the year ended December 31, 2011, for a description of the assumptions used in determining the accounting expense associated with these awards.

On February 25, 2011, each non-management director, except for Mr. Slater, received an award of 7,936 shares of restricted stock with a grant date fair value of $8.82 per share. As of December 31, 2011, each non-management director held 9,779 shares of common stock, and 1,317 restricted stock units, except for Mr. Wheat, who held 9,947 shares of common stock and 2,874 restricted stock units. Mr. Slater held no shares. See footnote 3 below.

(3) At his request, Mr. Slater, who was nominated by our largest stockholder to serve on our board, has waived all director compensation. See Review and Approval of Transactions With Related Persons Certain Relationships and Related Transactions for a description of Mr. Slater s employment relationship with Paulson & Co.

The following table sets forth the number of shares held by each of the non-management directors that are standing for re-election at the 2012 annual meeting of stockholders as of March 26, 2012.

Name of Director	Number of Shares Held(1)
Edward J. Bayone	15,657
Robert C. Blattberg	15,657
Charles B. Carden	15,657
Thomas D. Gardner	15,657
David E. Hawthorne	15,657
Thomas S. Rogers	15,657
John Slater(2)	
Douglas D. Wheat	15,905

(1) Number of shares reported for all directors, except Mr. Wheat, includes restricted stock awards from 2010 (1,843 shares), 2011 (7,936 shares) and 2012 (5,000 shares) and two-thirds of the restricted stock unit awards from 2010, which partially vested on March 12, 2011 (439 shares) and March 12, 2012 (439 shares). Number of shares reported for Mr. Wheat includes restricted stock awards from 2010 (2,011 shares), 2011 (7,936 shares) and 2012 (5,000 shares) and one-third of the restricted stock unit award from 2010, which partially vested on July 1, 2011 (958 shares).

(2) At his request, Mr. Slater, who was nominated by our largest stockholder to serve on our board, has waived all director compensation. See Review and Approval of Transactions With Related Persons Certain Relationships and Related Transactions for a description of Mr. Slater s employment relationship with Paulson & Co.

Stock Ownership Guidelines

We do not currently have stock ownership guidelines for our non-management directors. However, all non-management directors who joined the board on December 31, 2009 received an award of restricted stock units that vest in three equal annual installments beginning on the first anniversary of the grant date, but do not settle until after the director s departure from the board in good standing. The board believes that the significant value of the restricted stock unit award, together with settlement only upon retirement from the board, helps to ensure that the financial interests of our directors continue to be aligned with those of the company s stockholders. The compensation committee periodically evaluates whether stock ownership guidelines should be adopted.

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COMPENSATION DISCUSSION AND ANALYSIS

Overview

Decisions with respect to compensation for our executive officers, including our president and chief executive officer, are made by the compensation committee of our board of directors (the *committee*). Below we describe the actions and philosophies of the committee during 2011.

The following discussion and analysis is focused primarily on the compensation for our executive officers during 2011, with additional detail provided for our named executive officers. Our *named executive officers* are:

- our president and chief executive officer;
- our chief financial officer; and
- the three other most highly compensated executive officers in 2011 who were serving as executive officers at the end of 2011.

The compensation of our named executive officers is presented in the tables and related information and discussed under Executive Compensation following this section.

Executive Summary

Our goal for the executive compensation program is to attract, motivate and retain a talented, entrepreneurial and creative team of executives who will provide leadership for our success in dynamic and competitive markets. We seek to accomplish this goal in a way that rewards individual performance and that is aligned with stockholders long-term interests.

Upon the emergence from Chapter 11, all outstanding common stock of the company (then known as Idearc Inc.) was cancelled effective as of December 31, 2009. In addition, all of our then-existing long-term incentive plans were terminated and all outstanding equity incentive awards were cancelled. Following our reorganization in 2009, the committee undertook a detailed review of our executive compensation program. The overall objective of this effort was to align the interests of our leadership team with our new stockholders and help support our dedicated efforts to significantly reduce operating costs and mitigate declines in revenue. In addition, the committee s objective was to design our executive compensation program to be market competitive while promoting the pay for performance philosophy.

Our executive compensation program includes a mix of fixed and variable compensation, including base salaries and annual and long-term incentives that create a balance between short-term and long-term focus. Incentive compensation of executive officers is based on a balanced mix of performance measures, including revenue, profitability and total stockholder return. In 2011, we maintained short-term incentive targets (after reducing them in 2010 for each executive officer except the chief executive officer), and reduced the grant value of long-term incentives after making substantial grants in 2010. Our profitability has met or exceeded the goals established for our short-term incentive plan and the projections published in the disclosure statement associated with our plan of reorganization. In addition, through significant expense control efforts, results in the majority of our financial earnings metrics, including EBITDA (both in terms of dollars and margin percentage) and earnings per share, reflected outperformance of our primary industry peers on a year over year basis. The company also reduced its total debt outstanding by $426 million in 2011, for a total reduction of over $1 billion in the last two years, through efficient utilization of its cash flows. As a result, our short-term incentive plan has paid at or above target in 2010 and 2011.

Our long-term incentive grants have the effect of linking executive compensation to the performance of our common stock and effectively align executive pay with the interests of our stockholders. Long-term incentive plan award recipients participate along with the other stockholders in the rise and fall of the company s share price over the years. The following table sets forth the number of shares of restricted stock and restricted stock units granted to the named executive officers in 2010 and 2011 and the aggregate grant date fair value of the awards, based upon the company s closing stock price on the grant date. The last column of the table below reflects the 2011 year-end value of the awards, based upon the company s closing share price on December 30, 2011, the last trading day of the year.

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Name	Restricted Stock (#) /Grant Date	Restricted Stock Units(#) /Grant Date	Grant Date Value ($)	2011 Year-End Value ($)
Peter J. McDonald	150,000			
	12/9/2010		1,087,500	396,000
Samuel D. Jones	35,550			
	3/12/2010		1,350,189	93,852
Frank P. Gatto	29,493			
	3/12/2010		1,120,144	77,862
Del Humenik		35,000		
		2/25/2011	308,700	92,400
Cody Wilbanks	33,575			
	3/12/2010		1,275,179	88,638

In addition, all of the stock options granted since our emergence from bankruptcy have an exercise price greater than the current market price of our common stock.

In 2011, the company received a favorable advisory vote on its executive compensation program, with over 92% of the company s shares voted to approve the executive compensation program. The committee believes this affirms the stockholders support of the company s executive compensation program, and the committee did not change its approach in 2011 based on the results of the advisory vote. The committee will continue to monitor and consider the outcomes of future advisory votes on the company s executive compensation program when making compensation decisions for the company s executive officers and will continue to focus on strengthening the pay for performance orientation of our executive compensation program and its alignment with long-term stockholder interests.

Compensation Philosophy and Objectives

In making compensation decisions for our executive officers, the committee is guided by a pay for performance philosophy. The committee believes a significant portion of each executive s total compensation opportunity should be tied to, and vary with, the relative achievement of the company s financial, operational and strategic goals and the market value of our common stock.

In designing the compensation program for executive officers, the committee seeks to achieve the following key objectives:

• Attract and Retain Talented Executives. The compensation program should provide each executive officer with a total compensation opportunity that is market competitive. This objective is intended to ensure that the company is able to attract and retain executives who will provide leadership for its success in dynamic and competitive markets while maintaining an appropriate cost structure for the company.

• Motivate Executives. The compensation program should encourage our executive officers to achieve the company s financial, operational and strategic goals.

- Alignment with Stockholders Interests.The compensation program should align executives interests with those of our stockholders, promoting actions that will have a long-term positive impact on total stockholder return.

- Compensation Should Be Transparent. The elements of our compensation program should be easily understood by both our executive officers and our stockholders.

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Elements of Our 2011 Executive Compensation Program

Our 2011 compensation program for executive officers included the compensation elements summarized in the table below.

Compensation Program Elements	Employees Covered	Description	Key Objectives Promoted
Annual Cash Compensation			
Base Salary	All salaried employees	Fixed annual cash compensation paid every two weeks.	Attract and retain talented employees.
Short-Term Incentive Programs	Available to executive officers and eligible employees	Variable cash compensation based on performance achieved against pre-established goals.	Motivate and reward achievement of financial, operational and strategic business goals.
Long-Term Equity-Based Compensation			
Stock Options	Executive officers	Stock options that provide participation in the appreciation in the value of the company s stock.	Attract, retain and motivate talented executives; share price appreciation.
Restricted Stock Units	Executive officers	Shares of stock that vest as a result of continued employment with the company.	Attract, retain and motivate talented executives; align executive and stockholders interests.
Retirement Benefits			
Savings Plan	Available to eligible employees	A 401(k) retirement savings plan that enables employees to contribute a portion of their compensation with the potential for a company matching contribution.	Designed to be market competitive given that most companies our size provide a 401(k) with a matching component.
Management and Excess Pension Plans	Available to eligible employees hired before 2006	Retirement benefits provided by Verizon prior to the spin-off. The plans were frozen by Verizon Communications Inc. (*Verizon*) in mid-2006. Except for employees	A legacy obligation transferred to the company in connection with our spin-off in 2006.

	whose benefits are grandfathered under this plan, the company no longer offers this benefit.

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Executive Retiree Life Insurance Plan	Available to eligible employees who (i) were within certain salary bands as of December 31, 2001 and (ii) retire with a pension (other than a deferred vested pension) from a plan that is sponsored by Verizon.	Retirement benefits provided by Verizon prior to the spin-off. The plan was frozen by Verizon in January 2002. Except for employees whose benefits are grandfathered under this plan, the company no longer offers this benefit.	A legacy obligation transferred to the company in connection with our spin-off in 2006.
Severance and Change in Control Benefits			
Severance Benefits absent a Change in Control	Executive officers	Severance benefits equal to a multiple of salary and short-term incentive in the event of a termination by the company without cause.	Designed to enable the company to attract and retain talented executives and to protect the company s interests through restrictive post-employment covenants, including non-competition and non-solicitation.
Severance Benefits in connection with a Change in Control	Executive officers	Severance benefits equal to a multiple of salary and short-term incentive in the event of a termination by the company without cause or by the executive for good reason following a change in control.	Designed to ensure that management is able to evaluate any potential change in control transaction objectively and provide for continuity of management in the event of a change in control.
Health and Welfare Benefits			
Health and Welfare Benefits	All salaried employees	Health, dental, vision, term life and disability insurance.	Customary benefits that enable the company to attract and retain employees as most companies of our size provide similar benefits.
Financial Planning and Other Benefits	Executive officers	Flexible allowances; financial planning; annual physical exams.	Customary benefits that enable the company to attract and retain employees as most companies of our size provide similar benefits

Committee s Role in Establishing Compensation

The committee approves, or recommends to the board for approval, all compensation decisions for our executive officers. One of the committee s key responsibilities is to ensure that our executives are appropriately compensated based upon their performance and contribution to the company s future growth and profitability. The committee s compensation decisions are guided and supported by the company s compensation philosophy and objectives, which include alignment with stockholders   interests as a key objective. The committee chair sets the agenda for all committee meetings, with input from management and the committee s executive compensation advisor.

Advisor to the Committee

The committee has retained Mercer, a wholly-owned subsidiary of Marsh & McLennan Companies, Inc., as its executive compensation advisor. In 2011, Mercer provided the committee with third-party data and advice with respect to its compensation decisions for all of our executive officers, including our president and chief executive officer. While Mercer works closely with the appropriate members of the company s management team, Mercer reports directly to the committee and only provides services relating to executive compensation matters that are requested and authorized by the committee. The aggregate fees paid for executive compensation consulting services provided to the committee in 2011 were $329,519.

In 2011, the company also retained Mercer to provide services unrelated to executive compensation, including compensation benchmarking surveys, licensing compensation management software and co-sourcing arrangements. The aggregate fees paid for those services, surveys and software in 2011 were $88,987. The committee did not review or approve the other services provided by Mercer, as those services were approved by management in the normal course of business. We have been advised by Mercer that the reporting relationship and compensation of the Mercer consultants who perform executive compensation consulting services for the committee is separate from, and is not determined by reference to, Mercer s or Marsh & McLennan s other lines of business and their other work for us. The committee considers these separate reporting relationships and compensation structures, and the other policies and procedures implemented by Mercer, to be adequate to ensure that Mercer s advice to the committee is objective and not influenced by the other relationships that the company has with Mercer and its Marsh & McLennan affiliates.

Management s Role in Establishing Compensation

The company s human resources department administers our executive compensation program. At the request of the committee or management, the executive vice president of human resources is responsible for making proposals to the committee for changes to our executive compensation program. The committee may also request its executive compensation advisor to review and provide suggestions for changes to the compensation program. Our executive vice president of human resources is the primary management contact for the committee chair.

In 2011, our chief executive officer, chief financial officer, executive vice president of human resources and general counsel attended most regularly-scheduled committee meetings to discuss executive compensation matters under consideration by the committee and to answer questions regarding those matters. The committee also regularly met in executive session without management present.

With the participation of our chief executive officer and other company management, the committee annually reviews and approves (or recommends to the board for approval) the corporate goals, objectives, and other key measures relevant to compensation of our executive officers. In consultation with the company management and our chief executive officer, the committee evaluates the performance of other executive officers in light of these agreed upon measures. The committee then, based on such evaluations and assessment of each executive s responsibilities and potential for future contributions to the company s success, determines and approves, or recommends to the Board for approval, such officers   compensation or changes to compensation, if any. The chief financial officer participates in committee meetings when performance goal setting or measurement is on the agenda.

With the participation of the company management, the committee also annually reviews and approves (or recommends to the board for approval) the corporate goals, objectives, and other key measures relevant to the compensation of our chief executive officer. The committee evaluates the performance of the chief executive officer in light of these agreed upon measures. The committee then, based on such evaluation, determines and approves, or recommends to the Board for approval, the chief executive officer s total compensation or changes to compensation, if any. Neither the chief executive officer nor other executive officers or management are directly involved in determining or recommending changes to the chief executive officer s compensation.

In addition, in determining the total compensation or changes to the compensation of our chief executive officer and other executive officers, the committee also evaluates market data provided by Mercer and other relevant information.

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Review of Compensation Program

In determining our executive compensation program, the committee considers the main factors described below. The committee s actions are influenced by the fact that the company completed its reorganization on December 31, 2009. The committee also takes into account a review by Mercer of our compensation program relative to market practices prevailing among companies recently completing reorganizations.

- Market Competitiveness. The committee reviews market data provided by its executive compensation advisor for each of the executive officers. The committee completes a market study at the beginning of each year to evaluate whether market trends suggest changes to the current compensation program and pay levels of the executives.

- Internal Equity. The committee considers the level of total compensation opportunity for the executive officers in relation to one another and contribution to the company s performance to ensure that each executive s contributions to company performance are appropriately reflected. The committee also considers the relationship between the compensation of our chief executive officer and the company s other executive officers.

- Alignment with Stockholder s Interests.The committee considers equity awards to further the alignment of executive s interests with those of our stockholders.

- Individual Performance. The committee considers each individual executive s performance and the potential for the executive to expand his or her responsibilities and contributions to the company.

- Cost Cutting Efforts. The committee considers the company s continuous efforts to reduce operating costs in 2011.

Employment Agreements

President and Chief Executive Officer

In October 2010, the company entered into an interim employment agreement and in December 2010 into a new employment agreement with Peter J. McDonald in connection with his appointment as our president and chief executive officer. The agreement expires on December 13, 2013, unless extended. The agreement provides for an annual base salary of $900,000 and Mr. McDonald is eligible to earn an annual incentive award with a target value equal to 100% of his base salary. Also in connection with his appointment as our president and chief executive officer, Mr. McDonald was awarded (i) a one-time cash payment of $750,000 as a signing incentive and relocation payment; (ii) stock options to purchase 150,000 shares of the company s common stock; and (iii) a restricted stock award for 150,000 shares of the company s common stock.

For a description of the material terms of Mr. McDonald s employment agreement, see Executive Compensation President and CEO Employment Agreement and Executive Compensation Potential Payments Upon Termination or Change in Control President and CEO Employment Agreement.

Other Executive Officers

The company does not have employment agreements with any executive officers except for Mr. McDonald. Other executive officers are eligible to receive severance benefits and are subject to certain restrictive covenants under the company s executive transition plan. This plan was approved by the committee in April 2007 and amended and restated in May and November 2010, and was designed primarily to encourage executives to remain employed by the company by providing certain severance protection against involuntary termination of employment with additional severance protection applicable to a termination of employment in connection with a change in control. The company also eliminated gross-up payments associated with excise taxes on severance benefits following a change in control for new participants. For additional information about this plan, see Executive Compensation Potential Payments Upon Termination or Change in Control Executive Transition Plan.

Benchmarking and Comparator Group

In 2011, the committee reviewed the comparator group of companies in consultation with Mercer and other market data to be used to provide market references in establishing the total compensation opportunity for our executive officers. The

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comparator group includes companies that are similar to our company and is used to provide market references in establishing the total compensation opportunity for our executive officers. For 2011, this group comprised:

- A. H. Belo Corporation
- AOL Inc.
- Dex One Corporation
- The E.W. Scripps Company
- Gannett Co., Inc.
- GSI Commerce Inc.
- Harte Hanks Inc.
- IAC/InterActiveCorp
- Lee Enterprises, Inc.
- The McClatchy Company
- Media General, Inc.
- The New York Times Company
- Valassis Communications, Inc.
- Valueclick Inc.
- The Washington Post Company

When reviewing compensation data from the comparator group, the committee considered the peers profiles across several metrics including:

	SuperMedia Positioning (in July 2011)
Sales	Between 50th and 75th percentile
EBITDA	Between 50th and 75th percentile
Equity market value	Below the 25th Percentile
Enterprise Value	Between 50th and 75th percentile

The committee concluded that the company s high debt relative to equity made sales, earnings before interest, taxes, depreciation and amortization (EBITDA), and enterprise value more valid measures of comparative size than equity market value and concluded, with Mercer s concurrence, that the comparator group is a valid group for pay comparisons.

2011 Compensation Program

Throughout 2011, the committee reviewed compensation data from the comparator group, supplemented by benchmark compensation data from relevant executive compensation surveys, in order to evaluate proposed annual base salaries and incentive award opportunities for 2011. The committee s primary objective was to balance the need to offer appropriate compensation opportunities to the company s executives with the company s need to reduce operating expenses. In addition, the committee took into consideration the reintroduction of stock-based incentives as a component of executive officer pay in 2010, in order to further the alignment between executive compensation and stockholders interests.

Based on these objectives, the committee decided to keep 2011 base salaries and annual incentive targets at the same level as in 2010, since annual incentive targets were reduced in 2010 as a percent of base salary for all of the company s executive positions except for the chief executive officer.

While the committee used market competitiveness as a guideline, it also considered individual performance, changes in responsibilities from the prior year, experience, potential for future contributions, internal pay equity and the current economic conditions impacting our business and industry. In addition, the committee exercised its judgment regarding the appropriate compensation levels necessary to retain individuals qualified and motivated to lead the company through the current market and industry conditions.

Base Salary

Base salaries provide our executive officers with a predictable level of income. The committee typically reviews base salaries of our executive officers on an annual basis. During the committee s review of base salaries for executive officers for 2011, the committee primarily considered market data provided by the committee s advisor, individual responsibilities, performance and experience of the executive officer, recommendations made by our chief executive officer, internal pay equity among all of our executive officers and requirements to attract key talent to the organization.

In 2011, the committee reviewed market data indicating the market position of our executive officers relative to similar positions at the companies comprising the comparator group. Based upon this market data and consideration of the other factors described above, the committee determined not to increase the base salaries of our named executive officers in 2011. The committee approved a company-wide budget of 3% for base salary increases in 2012 for all employees, including our executive officers, effective April 1, 2012.

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Incentive Compensation

In February 2011, the committee approved grants of stock option and restricted stock unit awards under the company s 2009 long-term incentive plan, effective as of February 25, 2011. The stock options and restricted stock units vest over three years in equal installments of one-third on the first, second, and third anniversaries of the grant date. Pursuant to the terms of the company s 2009 long-term incentive plan and award agreements, all unvested options and restricted stock units will terminate upon the employee s termination of employment with the company for any reason on or before the third anniversary date of the award, except that the committee, at its sole option and election, may permit unvested options or restricted stock units not to terminate if the employee is terminated without cause. If a change in control occurs on or before the third anniversary date of the award, all unvested options and restricted stock units will immediately vest.

The differences in the equity awards between the named executive officers were primarily the result of differences in the applicable estimated market level of equity compensation for their positions, and not the application of any formula designed to maintain differentials between the officers.

The following named executive officers were granted options to purchase shares of our common stock and restricted stock units in the amounts set forth below:

Name	**Stock Options**	**Restricted Stock Units**
Samuel D. Jones	40,000	
Frank P. Gatto	10,000	
Del Humenik	20,000	35,000
Cody Wilbanks	16,000	

In February 2011, the committee approved target opportunities for each named executive officer under the 2011short-term incentive compensation plan, pursuant to the company s 2009 long-term incentive plan. The target awards were set at a percentage of the individual executive officer s base salary and were the same as 2010 short-term incentive targets. Award opportunities were subject to the company achieving levels of performance for the following metrics:

- *Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA).* The committee selected this metric because it provides a measure of the company s performance and ability to service debt and reinvest in growth initiatives. The committee also believes EBITDA to be a strong indicator of the company s cash flow, which the committee determined to be an important metric given the company s level of indebtedness. EBITDA is a non-GAAP measure. The committee calculated EBITDA by adding GAAP depreciation and amortization to GAAP operating income. The committee also added the costs related to restructuring, certain one-time compensation and benefit costs and fresh start accounting items. The committee retained discretion to adjust EBITDA for unusual or one-time items.

- *Multi-product Ad Sales.* The committee selected this metric because it is useful for comparing advertising sales for current advertising periods to corresponding sales for previous periods. The committee retained discretion to adjust multi-product ad sales for unusual or one-time items.

The committee decided that the performance metrics should be weighted 70% for EBITDA and 30% for multi-product ad sales to balance the company s focus on revenue growth and cash flows to service debt and other initiatives. The committee also established threshold, target and maximum levels of performance for each metric. No payments would be made for performance that is below the threshold for either metric and the maximum award payable for performance at or above the pre-determined maximum level is equal to 200% of an executive officer s target opportunity. The following table illustrates potential payouts associated with various levels of performance under the plan.

		Performance Goals as a Percent of Target				
Performance Metrics	**Weight**	**Below Threshold**	**Between Threshold and Target**	**Target**	**Between Target and Maximum**	**At or Above Maximum**
EBITDA	70%	<90%	90% to 99%	100%	101% to 119%	120%
Multi-product Ad Sales	30%	<92%	92% to 99%	100%	101% to 109%	110%
Potential payout as a percent of target:		**0%**	**25% to 99%**	**100%**	**101% to 199%**	**200%**

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In accordance with the terms of the short-term incentive plan, an executive officer s actual payout may be increased or decreased based on individual performance. The performance evaluation includes objective measures established for each executive officer.

The following table sets forth the threshold, target and maximum levels of performance, the weights of each performance metric and performance attained for each of these metrics in 2011.

Performance Metrics	Weight	Threshold	Performance Goals ($ in millions) Target	Maximum	% Target Award Attained Actual
EBITDA	70%	$ 540	$ 600	$ 720	115%
Multi-product Ad Sales	30%	$ 1,503	$ 1,634	$ 1,797	83%

In February 2012, the committee reviewed the company s performance against the specified performance metrics under the 2011 short-term incentive plan. The committee considered the extraordinary business-related items that impacted short-term incentive plan performance and evaluated adjustments to plan targets and results that included extraordinary items.

Based on overall company performance for 2011, including adjustments for extraordinary items related to both EBITDA and multi-product ad sales, the calculated payout for executive officers was 101.04% of target. In order to balance the company s above-target performance on EBITDA with below-target performance on multi-product ad sales, the committee exercised discretion and determined that the short-term incentive plan payout for 2011 would be fixed at 100%, resulting in target award values for each of the company s named executive officers. The awards were paid in February 2012. The amounts paid to the named executive officers under the annual incentive plan are included in the Summary Compensation Table under Non-Equity Incentive Plan Compensation.

As previously described, the committee approved 2011 target short-term incentive opportunities for each named executive officer that were the same as the 2010 short-term incentive targets, except for our chief executive officer. The following table sets forth the short-term incentive target opportunities and the actual 2011 short-term incentive award payouts based on performance achieved under the 2011 short-term incentive plan, as a percentage of base salary, for each of our named executive officers that had an opportunity to earn a short-term incentive award in 2011.

Name	2011 Target Annual Incentive Opportunity (% of base salary)	Actual 2011 Award Payout (% of base salary)
Peter J. McDonald	100%	100%
Samuel D. Jones	75%	75%
Frank P. Gatto	70%	70%
Del Humenik	70%	70%
Cody Wilbanks	70%	70%

As part of its compensation review with respect to key management personnel, the committee approved an award of special bonuses to two of our executive officers in recognition of their significant contributions during 2011. The committee approved the payment of a special bonus in the amount of $100,000 to Mr. Jones, the company s chief financial officer, for his leadership in the company s expense reduction initiatives that contributed to the improvement in operating results that the committee considers significant to the company s deleveraging effort, which resulted in efficient utilization of cash flows to reduce our senior secured term loans by $426 million in 2011. The committee also approved a special bonus in the amount of $100,000 to Mr. Humenik, the company s executive vice president sales, to recognize his efforts in developing and implementing the transition to the company s new business model focused on becoming a trusted marketing partner for small and medium businesses across search, mobile, social and traditional media, designed to effectively connect advertisers with their target audiences through a variety of digital advertising solutions.

Other Benefits

Our executive officers are eligible to participate in various benefit plans available generally to our employees. Under these plans, all employees are entitled to access to health, dental, vision, term life insurance and disability coverage. All employees, including our executive officers, are also eligible to receive vacation, sick leave and other paid holidays. Former employees of Verizon s directories business and employees with at least 131/2 years of service as of June 30, 2006 are also

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entitled to post-retirement medical benefits. We assumed this obligation to provide post-retirement medical benefits from Verizon in connection with the spin-off in 2006.

The executive officers are also eligible to receive the following benefits:

- annual physical examinations;
- financial planning resources, services and assistance; and
- flexible allowances.

The company also reimburses a portion of the premiums associated with whole life insurance policies for those executive officers who received this benefit as Verizon employees prior to the spin-off in 2006. In addition, the company provides these executive officers with payments for taxes owed by the executives as a result of the premiums reimbursed by the company. This benefit was provided by Verizon prior to the spin-off in 2006. For 2011, the committee decided to continue to provide this benefit only to those executive officers who were eligible to receive it from Verizon prior to the spin-off. In 2011, only Mr. Gatto received this benefit.

The committee approved the flexible allowance for executives in lieu of other benefits historically provided by our former parent company, such as car allowances and club dues. For additional information regarding benefits provided by the company, see the Executive Compensation Summary Compensation Table All Other Compensation.

Savings Plan

Our executive officers and other employees are eligible to participate in the SuperMedia Savings Plan. Participants can elect to contribute to this plan on a pre-tax and/or post-tax basis and receive a company matching contribution of up to 6% of eligible compensation, which includes base salary and annual short-term incentives, subject to applicable Internal Revenue Service limitations. Management employees are eligible for an additional company matching contribution under the plan of up to 3% of eligible compensation if company performance criteria, established by the committee, are met. For 2011, based on the company s relative achievement against these measures, the committee determined that no supplemental contributions would be made.

Pension Plans

In connection with the spin-off, Verizon transferred to the company certain pension assets and liabilities related to our employees, including some of our executive officers. The benefit obligations are now provided under company pension plans. These plans were frozen by Verizon and do not accept new participants. For a description of these plans and the benefits payable to the named executive officers, see Executive Compensation 2011 Pension Benefits.

Potential Benefits and Payments upon Severance and Change in Control

We provide our executive officers with severance benefits in the event of a termination of employment without cause or in connection with a change in control of the company. These benefits are provided to our president and chief executive officer pursuant to his employment agreement. For our other executive officers, these benefits are provided pursuant to the company s executive transition plan. The severance benefits are designed to assist the company in attracting and retaining talented executives. In addition, the change in control severance benefits are intended to (a) ensure that our executives are able, as a practical matter, to evaluate any potential change in control transaction objectively, (b) encourage executives to remain employed by the company in the event a change in control becomes a real possibility and (c) protect the company s interests through restrictive post-employment covenants, including noncompetition and nonsolicitation. For additional information, see Executive Compensation Potential Payments Upon Termination or Change in Control.

Stock Ownership Guidelines

We currently have stock ownership guidelines only for Mr. McDonald, our president and chief executive officer. Pursuant to his employment agreement, Mr. McDonald is required to maintain ownership of at least 50% of the vested restricted stock (net of any shares withheld to pay taxes) and exercised stock options awarded to Mr. McDonald under his employment agreement during the term of his employment with the company and for six months thereafter. These stock ownership guidelines terminate in the event of Mr. McDonald s death or disability.

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Hedging Transactions

As part of the company s code of conduct, we have a policy prohibiting employees from engaging in transactions involving risks associated with the fluctuations in the company s share price.

Impact of Regulatory Compliance

Deductibility of Compensation

Section 162(m) of the Internal Revenue Code places a limit of $1,000,000 on the amount of compensation the company may deduct for federal income tax purposes in any one year with respect to the chief executive officer and the next four most highly compensated officers (excluding the principal financial officer) who were serving as executive officers as of the last day of the applicable year. Performance-based compensation that meets certain requirements is excluded from this limitation.

The committee considers the anticipated tax treatment to the company and to our executive officers of various payments and benefits. However, the deductibility of certain compensation payments depends upon the timing of an executive s vesting or exercise of previously granted awards, as well as interpretations and changes in the tax laws and other factors beyond the committee s control. For these and other reasons, including the need to maintain flexibility in compensating executive officers in a manner designed to promote varying corporate goals, the committee will not necessarily, or in all circumstances, limit executive compensation to that which is deductible under Section 162(m) and has not adopted a policy requiring that all compensation be deductible.

The committee will also consider various practicable alternatives to preserving the deductibility of compensation payments and benefits to the extent consistent with its other compensation objectives. The committee may establish performance criteria in an effort to ensure the deductibility of short-term cash incentives and also the deductibility of compensation resulting from equity awards made under the long-term incentive plan. Base salary does not qualify as performance-based compensation under Section 162(m). The company currently expects that all compensation paid to the named executive officers in 2011 will be deductible by the company.

Taxation of Nonqualified Deferred Compensation

To the extent the committee permits executive officers to defer their own compensation, or commits to deliver compensation at a later date than when earned and vested, the committee will make efforts to ensure that the requirements of Section 409A of the Internal Revenue Code are satisfied. Failure to satisfy Section 409A requirements could subject the executive officers receiving nonqualified deferred compensation to a 20% excise tax.

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COMPENSATION COMMITTEE REPORT

The compensation committee is currently comprised of three directors: David E. Hawthorne (Chair), Thomas D. Gardner and Thomas S. Rogers. The members of the compensation committee reviewed and discussed the Compensation Discussion and Analysis with management. Based on this review and discussion, the members of the compensation committee recommended to our board of directors that the Compensation Discussion and Analysis be included in the company s annual report on Form 10-K for the year ended December 31, 2011 and this proxy statement on Schedule 14A.

David E. Hawthorne, Chair

Thomas D. Gardner

Thomas S. Rogers

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EXECUTIVE COMPENSATION

The following executive compensation tables and related information are intended to be read together with the more detailed disclosure regarding our executive compensation program presented under the caption Compensation Discussion and Analysis above.

Summary Compensation Table

The following table sets forth information regarding the compensation of our named executive officers.

Name and Principal Position	Year	Salary	Bonus	Stock Awards	Option Awards(3)	Non-Equity Incentive Plan Compensation(4)	Change in Pension Value(5)	All Other Compensation(6)	Total
Peter J. McDonald	2011	$ 900,000				$ 900,000		$ 34,788	$ 1,834,788
President and Chief Executive Officer	2010	204,231	$ 850,000	$ 1,087,500	$ 628,500			3,115	2,773,346
Samuel D. Jones	2011	450,000	100,000(1)		210,800	337,500	242,742	46,075	1,387,117
Executive Vice President,	2010	447,500	225,000	1,350,189		428,996	221,814	49,390	2,722,889
Chief Financial Officer and Treasurer	2009	382,500	225,000			291,160	257,852	47,062	1,203,574

Other	591		591		92
Total commercial real estate	1,437	263	1,700		194
Residential real estate:					
Consumer mortgages	742		742		
Investment property		154	154		
Total residential real estate	742	154	896		
Total	$ 2,249	1,022	3,271	$	194

At June 30, 2015, there were no significant outstanding commitments to advance additional funds to customers whose loans had been restructured.

The following table summarizes loans modified in a TDR during the respective periods both before and after their modification.

(Dollars in thousands)	Quarter ended June 30, Number of contracts		Quarter ended June 30, Pre-modification outstanding recorded investment	Quarter ended June 30, Post-modification outstanding recorded investment	Six months ended June 30, Number of contracts		Six months ended June 30, Pre-modification outstanding recorded investment	Six months ended June 30, Post-modification outstanding recorded investment
2015:								
Commercial and industrial	1	$	61	66	1	$	61	66
Construction and land development					1		116	113
Commercial real estate:								
Other					1		592	592
Total commercial real estate					1		592	592
Total	1	$	61	66	3	$	769	771

The majority of the loans modified in a TDR during the quarter and six months ended June 30, 2015, included permitting delays in required payments of principal and/or interest or where the only concession granted by the Company was that the interest rate at renewal was considered to be less than a market rate. There were no loans modified in a TDR during the six months ended June 30, 2014.

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The following table summarizes the recorded investment in loans modified in a TDR within the previous 12 months for which there was a payment default (defined as 90 days or more past due) during the respective periods. There were no loans modified in a TDR which had a payment default during the six months ended June 30, 2014.

	Quarter ended June 30,		Six months Ended June 30,	
	Number of	Recorded	Number of	Recorded
(Dollars in thousands)	**Contracts**	**investment(1)**	**Contracts**	**investment(1)**
2015:				
Commerical real estate:				
Owner occupied		$	1	$ 261
Total commercial real estate			1	261
Residential real estate:				
Investment property			1	150
Total residential real estate			1	150
Total		$	2	$ 411

(1) Amount as of applicable month end during the respective period for which there was a payment default.

NOTE 6: MORTGAGE SERVICING RIGHTS, NET

Mortgage servicing rights (MSRs) are recognized based on the fair value of the servicing rights on the date the corresponding mortgage loans are sold. An estimate of the fair value of the Company s MSRs is determined using assumptions that market participants would use in estimating future net servicing income, including estimates of prepayment speeds, discount rates, default rates, cost to service, escrow account earnings, contractual servicing fee income, ancillary income, and late fees. Subsequent to the date of transfer, the Company has elected to measure its MSRs under the amortization method. Under the amortization method, MSRs are amortized in proportion to, and over the period of, estimated net servicing income.

The Company has recorded MSRs related to loans sold without recourse to Fannie Mae. The Company generally sells conforming, fixed-rate, closed-end, residential mortgages to Fannie Mae. MSRs are included in other assets on the accompanying consolidated balance sheets.

The Company evaluates MSRs for impairment on a quarterly basis. Impairment is determined by stratifying MSRs into groupings based on predominant risk characteristics, such as interest rate and loan type. If, by individual stratum, the carrying amount of the MSRs exceeds fair value, a valuation allowance is established. The valuation allowance is adjusted as the fair value changes. Changes in the valuation allowance are recognized in earnings as a component of mortgage lending income.

The following table details the changes in amortized MSRs and the related valuation allowance for the respective periods.

(Dollars in thousands)	**Quarter ended June 30,**		**Six Months Ended June 30,**	
	2015	**2014**	**2015**	**2014**
MSRs, net:				
Beginning balance	$ 2,355	$ 2,368	$ 2,388	$ 2,350
Additions, net	154	105	265	203
Amortization expense	(199)	(84)	(333)	(164)
Decrease (increase) in valuation allowance	49	(43)	39	(43)
Ending balance	$ 2,359	$ 2,346	$ 2,359	$ 2,346
Valuation allowance included in MSRs, net:				
Beginning of period	$ 63	$	$ 53	$
End of period	14	43	14	43
Fair value of amortized MSRs:				
Beginning of period	$ 3,066	$ 3,386	$ 3,238	$ 3,452
End of period	3,014	3,228	3,014	3,228

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NOTE 7: DERIVATIVE INSTRUMENTS

Financial derivatives are reported at fair value in other assets or other liabilities on the accompanying Consolidated Balance Sheets. The accounting for changes in the fair value of a derivative depends on whether it has been designated and qualifies as part of a hedging relationship. For derivatives not designated as part of a hedging relationship, the gain or loss is recognized in current earnings within other noninterest income on the accompanying consolidated statements of earnings. From time to time, the Company may enter into interest rate swaps (swaps) to facilitate customer transactions and meet their financing needs. Upon entering into these swaps, the Company enters into offsetting positions in order to minimize the risk to the Company. These swaps qualify as derivatives, but are not designated as hedging instruments.

Interest rate swap agreements involve the risk of dealing with counterparties and their ability to meet contractual terms. When the fair value of a derivative instrument is positive, this generally indicates that the counterparty or customer owes the Company, and results in credit risk to the Company. When the fair value of a derivative instrument is negative, the Company owes the customer or counterparty and therefore, has no credit risk.

A summary of the Company s interest rate swap agreements at June 30, 2015 and December 31, 2014 is presented below.

(Dollars in thousands)		**Notional**	**Other Assets Estimated Fair Value**	**Other Liabilities Estimated Fair Value**
June 30, 2015:				
Pay fixed / receive variable	$	4,492		552
Pay variable / receive fixed		4,492	552	
Total interest rate swap agreements	$	8,984	552	552
December 31, 2014:				
Pay fixed / receive variable	$	4,667		634
Pay variable / receive fixed		4,667	634	
Total interest rate swap agreements	$	9,334	634	634

NOTE 8: FAIR VALUE

Fair Value Hierarchy

Fair value is defined by ASC 820, *Fair Value Measurements and Disclosures*, as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for an asset or liability at the measurement date. GAAP establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs to the valuation methodology are unobservable and reflect the Company s own assumptions about the inputs market participants would use in pricing the asset or liability.

Level changes in fair value measurements

Transfers between levels of the fair value hierarchy are generally recognized at the end of the reporting period. The Company monitors the valuation techniques utilized for each category of financial assets and liabilities to ascertain when transfers between levels have been affected. The nature of the Company s financial assets and liabilities generally is such that transfers in and out of any level are expected to be infrequent. For the six months ended June 30, 2015, there were no transfers between levels and no changes in valuation techniques for the Company s financial assets and liabilities.

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Assets and liabilities measured at fair value on a recurring basis

Securities available-for-sale

Fair values of securities available for sale were primarily measured using Level 2 inputs. For these securities, the Company obtains pricing from third party pricing services. These third party pricing services consider observable data that may include broker/dealer quotes, market spreads, cash flows, benchmark yields, reported trades for similar securities, market consensus prepayment speeds, credit information, and the securities terms and conditions. On a quarterly basis, management reviews the pricing received from the third party pricing services for reasonableness given current market conditions. As part of its review, management may obtain non-binding third party broker quotes to validate the fair value measurements. In addition, management will periodically submit pricing provided by the third party pricing services to another independent valuation firm on a sample basis. This independent valuation firm will compare the price provided by the third party pricing service with its own price and will review the significant assumptions and valuation methodologies used with management.

Interest rate swap agreements

The carrying amount of interest rate swap agreements was included in other assets and accrued expenses and other liabilities on the accompanying consolidated balance sheets. The fair value measurements for our interest rate swap agreements were based on information obtained from a third party bank. This information is periodically tested by the Company and validated against other third party valuations. If needed, other third party market participants may be utilized to corroborate the fair value measurements for our interest rate swap agreements. The Company classified these derivative assets and liabilities within Level 2 of the valuation hierarchy. These swaps qualify as derivatives, but are not designated as hedging instruments.

The following table presents the balances of the assets and liabilities measured at fair value on a recurring basis as of June 30, 2015 and December 31, 2014, respectively, by caption, on the accompanying consolidated balance sheets by ASC 820 valuation hierarchy (as described above).

(Dollars in thousands)	**Amount**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
June 30, 2015:				
Securities available-for-sale:				
Agency obligations	$ 60,219		60,219	
Agency RMBS	122,113		122,113	

State and political subdivisions	70,574	70,574
Total securities available-for-sale	252,906	252,906
Other assets [1]	552	552
Total assets at fair value	$ 253,458	253,458
Other liabilities[1]	$ 552	552
Total liabilities at fair value	$ 552	552
December 31, 2014:		
Securities available-for-sale:		
Agency obligations	$ 60,249	60,249
Agency RMBS	135,043	135,043
State and political subdivisions	72,311	72,311
Total securities available-for-sale	267,603	267,603
Other assets [1]	634	634
Total assets at fair value	$ 268,237	268,237
Other liabilities[1]	$ 634	634
Total liabilities at fair value	$ 634	634

[1]Represents the fair value of interest rate swap agreements.

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Assets and liabilities measured at fair value on a nonrecurring basis

Loans held for sale

Loans held for sale are carried at the lower of cost or fair value. Fair values of loans held for sale are determined using quoted market secondary market prices for similar loans. Loans held for sale are classified within Level 2 of the fair value hierarchy.

Impaired Loans

Loans considered impaired under ASC 310-10-35, *Receivables*, are loans for which, based on current information and events, it is probable that the Company will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. Impaired loans can be measured based on the present value of expected payments using the loan s original effective rate as the discount rate, the loan s observable market price, or the fair value of the collateral less selling costs if the loan is collateral dependent.

The fair value of impaired loans were primarily measured based on the value of the collateral securing these loans. Impaired loans are classified within Level 3 of the fair value hierarchy. Collateral may be real estate and/or business assets including equipment, inventory, and/or accounts receivable. The Company determines the value of the collateral based on independent appraisals performed by qualified licensed appraisers. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Appraised values are discounted for costs to sell and may be discounted further based on management s historical knowledge, changes in market conditions from the date of the most recent appraisal, and/or management s expertise and knowledge of the customer and the customer s business. Such discounts by management are subjective and are typically significant unobservable inputs for determining fair value. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors discussed above.

Other real estate owned

Other real estate owned, consisting of properties obtained through foreclosure or in satisfaction of loans, are initially recorded at the lower of the loan s carrying amount or the fair value less costs to sell upon transfer of the loans to other real estate. Subsequently, other real estate is carried at the lower of carrying value or fair value less costs to sell. Fair values are generally based on third party appraisals of the property and are classified within Level 3 of the fair value hierarchy. The appraisals are sometimes further discounted based on management s historical knowledge, and/or changes in market conditions from the date of the most recent appraisal, and/or management s expertise and knowledge of the customer and the customer s business. Such discounts are typically significant unobservable inputs for determining fair value. In cases where the carrying amount exceeds the fair value, less costs to sell, a loss is recognized in noninterest expense.

Mortgage servicing rights, net

Mortgage servicing rights, net, included in other assets on the accompanying consolidated balance sheets, are carried at the lower of cost or estimated fair value. MSRs do not trade in an active market with readily observable prices. To determine the fair value of MSRs, the Company engages an independent third party. The independent third party s valuation model calculates the present value of estimated future net servicing income using assumptions that market participants would use in estimating future net servicing income, including estimates of prepayment speeds, discount rates, default rates, cost to service, escrow account earnings, contractual servicing fee income, ancillary income, and late fees. Periodically, the Company will review broker surveys and other market research to validate significant assumptions used in the model. The significant unobservable inputs include prepayment speeds or the constant prepayment rate (CPR) and the weighted average discount rate. Because the valuation of MSRs requires the use of significant unobservable inputs, all of the Company s MSRs are classified within Level 3 of the valuation hierarchy.

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The following table presents the balances of the assets and liabilities measured at fair value on a nonrecurring basis as of June 30, 2015 and December 31, 2014, respectively, by caption, on the accompanying consolidated balance sheets and by FASB ASC 820 valuation hierarchy (as described above):

(Dollars in thousands)		**Carrying Amount**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
June 30, 2015:					
Loans held for sale	$	3,875		3,875	
Loans, net[1]		1,851			1,851
Other real estate owned		499			499
Other assets [2]		2,359			2,359
Total assets at fair value	$	8,584		3,875	4,709
December 31, 2014:					
Loans held for sale	$	1,974		1,974	
Loans, net[1]		3,077			3,077
Other real estate owned		534			534
Other assets [2]		2,388			2,388
Total assets at fair value	$	7,973		1,974	5,999

[1]Loans considered impaired under ASC 310-10-35, *Receivables*. This amount reflects the recorded investment in
impaired loans, net of any related allowance for loan losses.
[2]Represents MSRs, net, carried at lower of cost or estimated fair value.

Quantitative Disclosures for Level 3 Fair Value Measurements

At June 30, 2015, the Company had no Level 3 assets measured at fair value on a recurring basis. For Level 3 assets measured at fair value on a non-recurring basis at June 30, 2015, the significant unobservable inputs used in the fair value measurements are presented below.

(Dollars in thousands)	**Carrying**	**Valuation Technique**	**Significant Unobservable Input**

	Amount				Weighted Average of Input
Nonrecurring:					
Impaired loans	$	1,851	Appraisal	Appraisal discounts (%)	22.4%
Other real estate owned		499	Appraisal	Appraisal discounts (%)	26.7%
Mortgage servicing rights, net		2,359	Discounted cash flow	Prepayment speed or CPR (%)	10.3%
				Discount rate (%)	10.0%

Fair Value of Financial Instruments

ASC 825, *Financial Instruments*, requires disclosure of fair value information about financial instruments, whether or not recognized on the face of the balance sheet, for which it is practicable to estimate that value. The assumptions used in the estimation of the fair value of the Company s financial instruments are explained below. Where quoted market prices are not available, fair values are based on estimates using discounted cash flow analyses. Discounted cash flows can be significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The following fair value estimates cannot be substantiated by comparison to independent markets and should not be considered representative of the liquidation value of the Company s financial instruments, but rather are a good-faith estimate of the fair value of financial instruments held by the Company. ASC 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements.

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The following methods and assumptions were used by the Company in estimating the fair value of its financial instruments:

Loans, net

Fair values for loans were calculated using discounted cash flows. The discount rates reflected current rates at which similar loans would be made for the same remaining maturities. This method of estimating fair value does not incorporate the exit-price concept of fair value prescribed by ASC 820 and generally produces a higher value than an exit-price approach. Expected future cash flows were projected based on contractual cash flows, adjusted for estimated prepayments.

Loans held for sale

Fair values of loans held for sale are determined using quoted secondary market prices for similar loans.

Time Deposits

Fair values for time deposits were estimated using discounted cash flows. The discount rates were based on rates currently offered for deposits with similar remaining maturities.

Long-term debt

The fair value of the Company s fixed rate long-term debt is estimated using discounted cash flows based on estimated current market rates for similar types of borrowing arrangements. The carrying amount of the Company s variable rate long-term debt approximates its fair value.

The carrying value, related estimated fair value, and placement in the fair value hierarchy of the Company s financial instruments at June 30, 2015 and December 31, 2014 are presented below. This table excludes financial instruments for which the carrying amount approximates fair value. Financial assets for which fair value approximates carrying value included cash and cash equivalents. Financial liabilities for which fair value approximates carrying value included noninterest-bearing demand deposits, interest-bearing demand deposits, and savings deposits due to these products having no stated maturity. In addition, financial liabilities for which fair value approximates carrying value included overnight borrowings such as federal funds purchased and securities sold under agreements to repurchase.

							Fair Value Hierarchy		
		Carrying		**Estimated**		**Level 1**		**Level 2**		**Level 3**
(Dollars in thousands)		**amount**		**fair value**		**inputs**		**inputs**		**Inputs**
June 30, 2015:										
Financial Assets:										
Loans, net (1)	$	403,609	$	408,327	$		$		$	408,327
Loans held for sale		3,875		3,897				3,897		
Financial Liabilities:										
Time Deposits	$	231,634	$	233,385	$		$	233,385	$	
Long-term debt		7,217		7,217				7,217		

December 31, 2014:					
Financial Assets:					
Loans, net (1)	$ 398,118	$ 407,839	$	$	$ 407,839
Loans held for sale	1,974	2,044		2,044	
Financial Liabilities:					
Time Deposits	$ 249,126	$ 251,365	$	$ 251,365	$
Long-term debt	12,217	12,558		12,558	

(1) Represents loans, net of unearned income and the allowance for loan losses.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

The following discussion and analysis is designed to provide a better understanding of various factors related to the results of operations and financial condition of Auburn National Bancorporation, Inc. (the Company) and its wholly owned subsidiary, AuburnBank (the Bank). This discussion is intended to supplement and highlight information contained in the accompanying unaudited condensed consolidated financial statements and related notes for the quarters and six months ended June 30, 2015 and 2014, as well as the information contained in our Annual Report on Form 10-K for the year ended December 31, 2014 and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2015.

Special Notice Regarding Forward-Looking Statements

Certain of the statements made in this discussion and analysis and elsewhere, including information incorporated herein by reference to other documents, are forward-looking statements within the meaning of, and subject to, the protections of Section 27A of the Securities Act of 1933, as amended, (the Securities Act) and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act).

Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, anticipations, assumptions, estimates, intentions and future performance, and involve known and unknown risks, uncertainties and other factors, which may be beyond our control, and which may cause the actual results, performance, achievements, or financial condition of the Company to be materially different from future results, performance, achievements, or financial condition expressed or implied by such forward-looking statements. You should not expect us to update any forward-looking statements.

All statements other than statements of historical fact are statements that could be forward-looking statements. You can identify these forward-looking statements through our use of words such as may, will, anticipate, assume, sho indicate, would, believe, contemplate, expect, estimate, continue, plan, point to, project, could, similar words and expressions of the future. These forward-looking statements may not be realized due to a variety of factors, including, without limitation:

- the effects of future economic, business, and market conditions and changes, domestic and foreign, including seasonality;

- governmental monetary and fiscal policies;

- legislative and regulatory changes, including changes in banking, securities, and tax laws, regulations and rules and their application by our regulators, including capital and liquidity requirements, and changes in the scope and cost of FDIC insurance;

- changes in accounting policies, rules, and practices;

the risks of changes in interest rates on the levels, composition, and costs of deposits, loan demand, and the values and liquidity of loan collateral, securities, and interest sensitive assets and liabilities, and the risks and uncertainty of the amounts realizable and the timing of dispositions of assets by the FDIC where we may have a participation or other interest;

changes in borrower credit risks and payment behaviors;

changes in the availability and cost of credit and capital in the financial markets, and the types of instruments that may be included as capital for regulatory purposes;

changes in the prices, values, and sales volumes of residential and commercial real estate;

the effects of competition from a wide variety of local, regional, national, and other providers of financial, investment, and insurance services;

- the failure of assumptions and estimates underlying the establishment of allowances for possible loan and other asset impairments, losses, and other estimates;

- changes in technology or products that may be more difficult, costly, or less effective than anticipated;

- the effects of war, or other conflicts, acts of terrorism, or other catastrophic events that may affect general economic conditions;

- the failure of assumptions and estimates, as well as differences in, and changes to, economic, market, and credit conditions, including changes in borrowers credit risks and payment behaviors from those used in our loan portfolio stress tests and other evaluations;

- the risk that our deferred tax assets could be reduced if estimates of future taxable income from our operations and tax planning strategies are less than currently estimated, and sales of our capital stock could trigger a reduction in the amount of net operating loss carry-forwards that we may be able to utilize for income tax purposes; and

- the other factors and information in this report and other filings that we make with the SEC under the Exchange Act, including our Annual Report on Form 10-K for the year ended December 31, 2014 and subsequent quarterly and current reports. See Part II, Item 1A. RISK FACTORS .

All written or oral forward-looking statements that are made by or attributable to us are expressly qualified in their entirety by this cautionary notice. We have no obligation and do not undertake to update, revise or correct any of the forward-looking statements after the date of this report, or after the respective dates on which such statements otherwise are made.

Business

The Company was incorporated in 1990 under the laws of the State of Delaware and became a bank holding company after it acquired its Alabama predecessor, which was a bank holding company established in 1984. The Bank, the Company s principal subsidiary, is an Alabama state-chartered bank that is a member of the Federal Reserve System and has operated continuously since 1907. Both the Company and the Bank are headquartered in Auburn, Alabama. The Bank conducts its business primarily in East Alabama, including Lee County and surrounding areas. The Bank operates full-service branches in Auburn, Opelika, Hurtsboro, Notasulga, and Valley, Alabama. In-store branches are located in the Kroger in Opelika and Wal-Mart SuperCenter stores in both Auburn and Opelika. The Bank also operates a commercial loan production office in Phenix City, Alabama.

Summary of Results of Operations

	Quarter ended June 30,		Six Months Ended June 30,	
(Dollars in thousands, except per share amounts)	**2015**	**2014**	**2015**	**2014**

Net interest income (a)	$	6,126	$	5,565	$	11,984	$	11,159
Less: tax-equivalent adjustment		338		312		673		636
Net interest income (GAAP)		5,788		5,253		11,311		10,523
Noninterest income		1,167		1,081		2,488		1,837
Total revenue		6,955		6,334		13,799		12,360
Provision for loan losses								(400)
Noninterest expense		4,029		3,792		8,343		7,740
Income tax expense		776		683		1,444		1,340
Net earnings	$	2,150	$	1,859	$	4,012	$	3,680
Basic and diluted earnings per share	$	0.59	$	0.51	$	1.10	$	1.01

(a) Tax-equivalent. See Table 1 - Explanation of Non-GAAP Financial Measures.

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Financial Summary

The Company s net earnings were $4.0 million for the first six months of 2015, compared to $3.7 million for the first six months of 2014. Basic and diluted earnings per share were $1.10 per share for the first six months of 2015, compared to $1.01 per share for the first six months of 2014.

Net interest income (tax-equivalent) was $12.0 million for the first six months of 2015, an increase of 7% compared to the first six months of 2014. The increase reflects management s efforts to increase earnings by shifting the Company s asset mix through loan growth, focusing on deposit pricing, and repaying higher-cost wholesale funding. Net interest income (tax-equivalent) for the first six months of 2015 included $0.2 million in recoveries of interest related to payoffs received on two loans that were previously impaired. Excluding the impact of these interest recoveries, net interest income (tax-equivalent) would have been $11.8 million for the first six months of 2015, an increase of 5% compared to the first six months of 2014. Average loans were $401.3 million in the first six months of 2015, an increase of $23.1 million or 6%, from the first six months of 2014. Average deposits were $702.6 million in the first six months of 2015, an increase of $21.1 million or 3%, from the first six months of 2014.

The Company recorded no provision for loan losses for the first six months of 2015, compared to a negative provision of $0.4 million for the first six months of 2014. Provision expense reflects the absolute level of loans, loan growth, the credit quality of the loan portfolio, and the amount of net charge-offs.

Noninterest income was $2.5 million for the first six months of 2015, compared to $1.8 million in the first six months of 2014. The increase was primarily due to an increase in income from bank-owned life insurance of $0.3 million related to death benefits recognized in the first six months of 2015 and an increase in net securities gains (losses) of $0.3 million due to other-than-temporary impairment charges recognized in the first quarter of 2014 related to available-for-sale, agency residential mortgage-backed securities the Company intended to sell at March 31, 2014, and subsequently sold in early April 2014.

Noninterest expense was $8.3 million in the first six months of 2015, compared to $7.7 million in the first six months of 2014. The increase was primarily due to prepayment penalties on long-term debt of $0.4 million incurred in the first six months of 2015 when the company repaid $5.0 million of long-term debt with a weighted average interest rate of 3.59% and an increase in other noninterest expense of $0.2 million.

Income tax expense was $1.4 million for the first six months of 2015, compared to $1.3 million for the first six months of 2014. The Company s income tax expense for the first six months of 2015 reflects an effective income tax rate of 26.47%, compared to 26.69% for the first six months of 2014. The Company s effective income tax rate is principally impacted by tax-exempt earnings from the Company s investments in municipal securities and bank-owned life insurance.

In the first six months of 2015, the Company paid cash dividends of $1.6 million, or $0.44 per share. The Company s balance sheet remains well capitalized under current regulatory guidelines with a total risk-based capital ratio of 17.78% and a Tier 1 leverage ratio of 10.39% at June 30, 2015.

In the second quarter of 2015, net earnings were $2.2 million, or $0.59 per share, compared to $1.9 million, or $0.51 per share, for the second quarter of 2014. Net interest income (tax-equivalent) was $6.1 million for the second quarter of 2015, an increase of 10% compared to the second quarter of 2014. Net interest income (tax-equivalent) for the second quarter of 2015 included $0.2 million in recoveries of interest related to payoffs received on two loans that were previously impaired. Excluding the impact of these interest recoveries, net interest income (tax-equivalent) would have been $5.9 million for the second quarter of 2015, an increase of 6% compared to the second quarter of

2014. The Company recorded no provision for loan losses in the second quarter of 2015 and 2014. Noninterest income was $1.2 million in the second quarter of 2015, compared to $1.1 million in the second quarter of 2014. The increase was primarily due to an increase in mortgage lending income of $0.1 million. Noninterest expense was $4.0 million in the second quarter of 2015, compared to $3.8 million in the second quarter of 2014. The increase was primarily due to an increase in net expenses related to OREO of $0.1 million and an increase in other noninterest expense of $0.1 million. Income tax expense was approximately $0.8 million for the second quarter of 2015, compared to $0.7 million for the second quarter of 2014. The Company s effective tax rate for the second quarter of 2015 was 26.52%, compared to 26.87% in the second quarter of 2014.

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CRITICAL ACCOUNTING POLICIES

The accounting and financial reporting policies of the Company conform with U.S. generally accepted accounting principles and with general practices within the banking industry. In connection with the application of those principles, we have made judgments and estimates which, in the case of the determination of our allowance for loan losses, our assessment of other-than-temporary impairment, recurring and non-recurring fair value measurements, the valuation of other real estate owned, and the valuation of deferred tax assets, were critical to the determination of our financial position and results of operations. Other policies also require subjective judgment and assumptions and may accordingly impact our financial position and results of operations.

Allowance for Loan Losses

The Company assesses the adequacy of its allowance for loan losses prior to the end of each calendar quarter. The level of the allowance is based upon management s evaluation of the loan portfolio, past loan loss experience, current asset quality trends, known and inherent risks in the portfolio, adverse situations that may affect a borrower s ability to repay (including the timing of future payment), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, industry and peer bank loan loss rates, and other pertinent factors, including regulatory recommendations. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. Loans are charged off, in whole or in part, when management believes that the full collectability of the loan is unlikely. A loan may be partially charged-off after a confirming event has occurred, which serves to validate that full repayment pursuant to the terms of the loan is unlikely.

The Company deems loans impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Collection of all amounts due according to the contractual terms means that both the interest and principal payments of a loan will be collected as scheduled in the loan agreement.

An impairment allowance is recognized if the fair value of the loan is less than the recorded investment in the loan. The impairment is recognized through the allowance. Loans that are impaired are recorded at the present value of expected future cash flows discounted at the loan s effective interest rate, or if the loan is collateral dependent, the impairment measurement is based on the fair value of the collateral, less estimated disposal costs.

The level of allowance maintained is believed by management to be adequate to absorb probable losses inherent in the portfolio at the balance sheet date. The allowance is increased by provisions charged to expense and decreased by charge-offs, net of recoveries of amounts previously charged-off.

In assessing the adequacy of the allowance, the Company also considers the results of its ongoing internal and independent loan review processes. The Company s loan review process assists in determining whether there are loans in the portfolio whose credit quality has weakened over time and evaluating the risk characteristics of the entire loan portfolio. The Company s loan review process includes the judgment of management, the input from our independent loan reviewers, and reviews that may have been conducted by bank regulatory agencies as part of their examination process. The Company incorporates loan review results in the determination of whether or not it is probable that it will be able to collect all amounts due according to the contractual terms of a loan.

As part of the Company s quarterly assessment of the allowance, management divides the loan portfolio into five segments: commercial and industrial, construction and land development, commercial real estate, residential real estate, and consumer installment. The Company analyzes each segment and estimates an allowance allocation for each loan segment.

The allocation of the allowance for loan losses begins with a process of estimating the probable losses inherent for each loan segment. The estimates for these loans are established by category and based on the Company s internal system of credit risk ratings and historical loss data. The estimated loan loss allocation rate for the Company s internal system of credit risk grades is based on its experience with similarly graded loans. For loan segments where the Company believes it does not have sufficient historical loss data, the Company may make adjustments based, in part, on loss rates of peer bank groups. At June 30, 2015 and December 31, 2014, and for the periods then ended, the Company adjusted its historical loss rates for the commercial real estate portfolio segment based, in part, on loss rates of peer bank groups.

The estimated loan loss allocation for all five loan portfolio segments is then adjusted for management s estimate of probable losses for several qualitative and environmental factors. The allocation for qualitative and environmental factors is particularly subjective and does not lend itself to exact mathematical calculation. This amount represents estimated probable inherent credit losses which exist, but have not yet been identified, as of the balance sheet date, and are based upon quarterly trend assessments in delinquent and nonaccrual loans, credit concentration changes, prevailing economic conditions, changes in lending personnel experience, changes in lending policies or procedures, and other influencing factors. These qualitative and environmental factors are considered for each of the five loan segments and the allowance allocation, as determined by the processes noted above, is increased or decreased based on the incremental assessment of these factors.

The Company regularly re-evaluates its practices in determining the allowance for loan losses. During 2014, the Company implemented certain refinements to its allowance for loan losses methodology in order to better capture the effects of the most recent economic cycle on the Company s loan loss experience. Beginning with the quarter ended June 30, 2014, the Company calculated average losses for all loan segments using a rolling 20 quarter historical period and continues to use this methodology.

Prior to June 30, 2014, the Company calculated average losses for all loan segments using a rolling 8 quarter historical period (except for the commercial real estate loan segment, which used a 6 quarter historical period). If the Company continued to calculate average losses for all loan segments other than commercial real estate using a rolling 8 quarter historical period and for the commercial real estate segment using a rolling 6 quarter historical period, the Company s calculated allowance for loan loss allocation would have decreased by approximately $1.0 million at June 30, 2014. Other than the changes discussed above, the Company has not made any material changes to its calculation of historical loss periods that would impact the calculation of the allowance for loan losses or provision for loan losses for the periods included in the accompanying consolidated balance sheets and statements of earnings.

Assessment for Other-Than-Temporary Impairment of Securities

On a quarterly basis, management makes an assessment to determine whether there have been events or economic circumstances to indicate that a security on which there is an unrealized loss is other-than-temporarily impaired. For equity securities with an unrealized loss, the Company considers many factors including the severity and duration of the impairment; the intent and ability of the Company to hold the security for a period of time sufficient for a recovery in value; and recent events specific to the issuer or industry. Equity securities for which there is an unrealized loss that is deemed to be other-than-temporary are written down to fair value with the write-down recorded as a realized loss in securities gains (losses).

For debt securities with an unrealized loss, an other-than-temporary impairment write-down is triggered when (1) the Company has the intent to sell a debt security, (2) it is more likely than not that the Company will be required to sell the debt security before recovery of its amortized cost basis, or (3) the Company does not expect to recover the entire amortized cost basis of the debt security. If the Company has the intent to sell a debt security or if it is more likely than not that it will be required to sell the debt security before recovery, the other-than-temporary write-down is equal to the entire difference between the debt security s amortized cost and its fair value. If the Company does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the other-than-temporary impairment write-down is separated into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security s amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security s fair value and the present value of future expected cash flows is due to factors that are not credit related and is recognized in other comprehensive income, net of applicable taxes.

Fair Value Determination

U.S. GAAP requires management to value and disclose certain of the Company s assets and liabilities at fair value, including investments classified as available-for-sale and derivatives. ASC 820, *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value in accordance with U.S.

GAAP and expands disclosures about fair value measurements. For more information regarding fair value measurements and disclosures, please refer to Note 8, Fair Value, of the consolidated financial statements that accompany this report.

Fair values are based on active market prices of identical assets or liabilities when available. Comparable assets or liabilities or a composite of comparable assets in active markets are used when identical assets or liabilities do not have readily available active market pricing. However, some of the Company s assets or liabilities lack an available or comparable trading market characterized by frequent transactions between willing buyers and sellers. In these cases, fair value is estimated using pricing models that use discounted cash flows and other pricing techniques. Pricing models and their underlying assumptions are based upon management s best estimates for appropriate discount rates, default rates, prepayments, market volatility, and other factors, taking into account current observable market data and experience.

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These assumptions may have a significant effect on the reported fair values of assets and liabilities and the related income and expense. As such, the use of different models and assumptions, as well as changes in market conditions, could result in materially different net earnings and retained earnings results.

Other Real Estate Owned

Other real estate owned (OREO), consists of properties obtained through foreclosure or in satisfaction of loans and is reported at the lower of cost or fair value, less estimated costs to sell at the date acquired, with any loss recognized as a charge-off through the allowance for loan losses. Additional OREO losses for subsequent valuation adjustments are determined on a specific property basis and are included as a component of other noninterest expense along with holding costs. Any gains or losses on disposal of OREO are also reflected in noninterest expense. Significant judgments and complex estimates are required in estimating the fair value of OREO, and the period of time within which such estimates can be considered current is significantly shortened during periods of market volatility. As a result, the net proceeds realized from sales transactions could differ significantly from appraisals, comparable sales, and other estimates used to determine the fair value of other OREO.

Deferred Tax Asset Valuation

A valuation allowance is recognized for a deferred tax asset if, based on the weight of available evidence, it is more-likely-than-not that some portion or the entire deferred tax asset will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of taxable income over the last three years and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that we will realize the benefits of these deductible differences at June 30, 2015. The amount of the deferred tax assets considered realizable, however, could be reduced if estimates of future taxable income are reduced.

RESULTS OF OPERATIONS

Average Balance Sheet and Interest Rates

	Six Months Ended June 30,			
	2015		2014	
(Dollars in thousands)	**Average Balance**	**Yield/ Rate**	**Average Balance**	**Yield/ Rate**
Loans and loans held for sale	$ 404,106	5.10%	$ 380,449	5.07%
Securities - taxable	193,694	2.07%	210,223	2.29%
Securities - tax-exempt	68,115	5.86%	60,954	6.19%
Total securities	261,809	3.06%	271,177	3.17%
Federal funds sold	60,789	0.21%	59,385	0.19%
Interest bearing bank deposits	24,449	0.23%	5,171	0.66%

Total interest-earning assets	751,153	3.83%	716,182	3.91%
Deposits:				
NOW	114,739	0.31%	106,812	0.32%
Savings and money market	207,027	0.40%	189,830	0.51%
Certificates of deposits less than $100,000	93,933	1.06%	104,079	1.20%
Certificates of deposits and other time deposits of $100,000 or more	145,124	1.45%	157,509	1.59%
Total interest-bearing deposits	560,823	0.76%	558,230	0.91%
Short-term borrowings	4,167	0.48%	3,440	0.53%
Long-term debt	9,372	3.53%	12,217	3.43%
Total interest-bearing liabilities	574,362	0.81%	573,887	0.96%
Net interest income and margin (tax-equivalent)	$ 11,984	3.22%	$ 11,159	3.14%

Net Interest Income and Margin

Net interest income (tax-equivalent) was $12.0 million for the first six months of 2015, compared to $11.2 million for the first six months of 2014. This increase reflects management s efforts to increase earnings by shifting the Company s asset mix through loan growth, focusing on deposit pricing, and repaying higher-cost wholesale funding. Net interest income (tax-equivalent) for the first six months of 2015 included $0.2 million in recoveries of interest related to payoffs received on two loans that were previously impaired. Excluding the impact of these interest recoveries, net interest income (tax-equivalent) would have been $11.8 million for the first six months of 2015, an increase of 5% compared to the first six months of 2014.

The tax-equivalent yield on total interest-earning assets decreased by 8 basis points in the first six months of 2015 from the first six months of 2014 to 3.83%. This decrease was primarily due to declining yields on securities and increased pricing competition for quality loan opportunities in our markets, which has limited the Company s ability to increase yields on new and renewed loans.

The cost of total interest-bearing liabilities decreased 15 basis points in the first six months of 2015 from the first six months of 2014 to 0.81%. The net decrease was largely a result of the continued shift in our funding mix, as we increased our lower-cost interest bearing demand deposits (NOW accounts), and savings and money market accounts and concurrently reduced balances of higher-cost certificates of deposits and long-term debt.

The Company continues to deploy various asset liability management strategies to manage its risk to interest rate fluctuations. The Company s net interest margin could experience pressure due to lower reinvestment yields in the securities portfolio given the current interest rate environment, increased competition for quality loan opportunities, and fewer opportunities to reduce our cost of funds due to the low level of deposit rates currently.

Provision for Loan Losses

The provision for loan losses represents a charge to earnings necessary to provide an allowance for loan losses that management believes, based on its processes and estimates, should be adequate to provide for the probable losses on outstanding loans. The Company recorded no provision for loan losses for the first six months of 2015, compared to a negative provision of $0.4 million for the first six months of 2014. Provision expense reflects the absolute level of loans, loan growth, the credit quality of the loan portfolio, and the amount of net charge-offs.

Based upon its assessment of the loan portfolio, management adjusts the allowance for loan losses to an amount it believes should be appropriate to adequately cover its estimate of probable losses in the loan portfolio. The Company s allowance for loan losses as a percentage of total loans was 1.20% at both June 30, 2015 and 2014. While the policies and procedures used to estimate the allowance for loan losses, as well as the resulting provision for loan losses charged to operations, are considered adequate by management and are reviewed from time to time by our regulators, they are based on estimates and judgments and are therefore approximate and imprecise. Factors beyond our control (such as conditions in the local and national economy, local real estate markets, or industry) may have a material adverse effect on our asset quality and the adequacy of our allowance for loan losses resulting in significant increases in the provision for loan losses.

Noninterest Income

	Quarter ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	**2015**	**2014**	**2015**	**2014**
Service charges on deposit accounts	$ 209	$ 219	$ 415	$ 432
Mortgage lending income	457	348	791	734
Bank-owned life insurance	112	125	513	251
Securities gains (losses), net		12	3	(295)
Other	389	377	766	715
Total noninterest income	$ 1,167	$ 1,081	$ 2,488	$ 1,837

Service charges on deposit accounts decreased primarily due to a decline in insufficient funds charges, reflecting changes in customer behavior and spending patterns.

The Company s income from mortgage lending was primarily attributable to the (1) origination and sale of new mortgage loans and (2) servicing of mortgage loans. Origination income, net, is comprised of gains or losses from the sale of the mortgage loans originated, origination fees, underwriting fees, and other fees associated with the origination of loans, which are netted against the commission expense associated with these originations. The Company s normal practice is to originate mortgage loans for sale in the secondary market and to either sell or retain the associated mortgage servicing rights (MSRs) when the loan is sold.

MSRs are recognized based on the fair value of the servicing right on the date the corresponding mortgage loan is sold. Subsequent to the date of transfer, the Company has elected to measure its MSRs under the amortization method. Servicing fee income is reported net of any related amortization expense.

MSRs are also evaluated for impairment on a quarterly basis. Impairment is determined by grouping MSRs by common predominant characteristics, such as interest rate and loan type. If the aggregate carrying amount of a particular group of MSRs exceeds the group s aggregate fair value, a valuation allowance for that group is established. The valuation allowance is adjusted as the fair value changes. An increase in mortgage interest rates typically results in an increase in the fair value of the MSRs while a decrease in mortgage interest rates typically results in a decrease in the fair value of MSRs.

The following table presents a breakdown of the Company s mortgage lending income.

	Quarter ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	**2015**	**2014**	**2015**	**2014**
Origination income	$ 386	$ 254	$ 644	$ 494
Servicing fees, net	22	137	108	283
Decrease (increase) in MSR valuation allowance	49	(43)	39	(43)
Total mortgage lending income	$ 457	$ 348	$ 791	$ 734

The increase in mortgage lending income was primarily due to an increase in origination income and changes in the MSR valuation allowance. These improvements were partially offset by a decrease in servicing fees, net of related amortization expense. Although servicing fees were largely unchanged, amortization expense increased due to faster prepayment speeds.

Income from bank-owned life insurance increased in the first six months of 2015, compared to the first six months of 2014 due to non-taxable death benefits received. Income from bank-owned life insurance decreased in the second quarter of 2015, compared to the second quarter of 2014 due to claims reducing the number of policies outstanding. The assets that support these policies are administered by the life insurance carriers and the income we receive (i.e. increases or decreases in the cash surrender value of the policies) on these policies is dependent upon the returns the insurance carriers are able to earn on the underlying investments that support these policies. Earnings on these policies are generally not taxable.

Net securities gains (losses) consist of realized gains and losses on the sale of securities and other-than-temporary impairment charges. The Company recorded an other-than-temporary impairment charge of $333,000 in the first quarter of 2014 related to securities that management intended to sell at March 31, 2014. Subsequent to March 31, 2014, the Company sold available-for-sale agency residential mortgage-backed securities (RMBS) with a fair value of $18.9 million and realized the expected loss of approximately $333,000. The Company incurred no other-than-temporary impairment charges in the first six months of 2015.

Noninterest Expense

	Quarter ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	**2015**	**2014**	**2015**	**2014**
Salaries and benefits	$ 2,291	$ 2,221	$ 4,559	$ 4,502
Net occupancy and equipment	362	341	720	693
Professional fees	218	225	419	431
FDIC and other regulatory assessments	118	129	243	274
Other real estate owned, net	1	(62)	18	56
Prepayment penalty on long-term debt			362	
Other	1,039	938	2,022	1,784
Total noninterest expense	$ 4,029	$ 3,792	$ 8,343	$ 7,740

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The decrease in FDIC and other regulatory assessments expense was primarily due to a decrease in the Bank s quarterly assessment rate as several variables utilized by the FDIC in calculating our deposit insurance assessments improved.

The decrease in OREO expense, net during the first six months of 2015, compared to the first six months of 2014, was primarily due to a decrease in expenses as the carrying amount and number of properties have declined. The increase in OREO expense, net during the second quarter of 2015, compared to the second quarter of 2014, was primarily due to gains realized on the sale of certain OREO properties in the second quarter of 2014.

During the first six months of 2015, the Company repaid $5.0 million of long-term debt with a weighted average interest rate of 3.59% and incurred prepayment penalties of $0.4 million.

The increase in other noninterest expense was due to various items, including computer software and marketing and business development expenses.

Income Tax Expense

Income tax expense was $1.4 million for the first six months of 2015, compared to $1.3 million for the first six months of 2014. The Company s income tax expense for the first six months of 2015 reflects an effective income tax rate of 26.47%, compared to 26.69% for the first six months of 2014. The Company s effective income tax rate is principally impacted by tax-exempt earnings from the Company s investments in municipal securities and bank-owned life insurance.

BALANCE SHEET ANALYSIS

Securities

Securities available-for-sale were $252.9 million at June 30, 2015, a decrease of $14.7 million, or 5%, compared to $267.6 million at December 31, 2014. This decline was primarily due to a decrease of $12.9 million in the amortized cost basis of securities available-for-sale as proceeds from sales, calls, and maturities were not reinvested and a $1.8 million change in unrealized gains (losses) on securities available-for-sale, reflecting a decrease in prices as long-term interest rates increased during the first six months of 2015.

The average tax-equivalent yields earned on total securities were 3.06% in the first six months of 2015 and 3.17% in the first six months of 2014.

Loans

		2015		2014	
		Second	**First**	**Fourth**	**Third**	**Second**
(In thousands)		**Quarter**	**Quarter**	**Quarter**	**Quarter**	**Quarter**
Commercial and industrial	$	57,310	52,536	54,329	52,868	52,054

Construction and land development	38,854	37,925	37,298	34,189	32,461
Commercial real estate	184,124	182,871	192,006	190,077	187,241
Residential real estate	115,039	111,265	107,641	106,555	102,921
Consumer installment	13,632	12,478	12,335	11,535	11,686
Total loans	408,959	397,075	403,609	395,224	386,363
Less: unearned income	(464)	(462)	(655)	(622)	(537)
Loans, net of unearned income	$ 408,495	396,613	402,954	394,602	385,826

Total loans, net of unearned income, were $408.5 million at June 30, 2015, compared to $403.0 million at December 31, 2014. Four loan categories represented the majority of the loan portfolio at June 30, 2015: commercial real estate (45%), residential real estate (28%), construction and land development (9%) and commercial and industrial (14%). Approximately 23% of the Company s commercial real estate loans were classified as owner-occupied at June 30, 2015.

Within the residential real estate portfolio segment, the Company had junior lien mortgages of approximately $16.3 million, or 4% of total loans, at June 30, 2015, compared to $16.5 million, or 4% of total loans, at December 31, 2014. For

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residential real estate mortgage loans with a consumer purpose, $1.9 million required interest-only payments at June 30, 2015 and December 31, 2014. The Company s residential real estate mortgage portfolio does not include any option ARM loans, subprime loans, or any material amount of other high-risk consumer mortgage products.

Purchased loan participations included in the Company s loan portfolio were approximately $1.5 million at June 30, 2015 and December 31, 2014. All purchased loan participations are underwritten by the Company independent of the selling bank. In addition, all loans, including purchased loan participations, are evaluated for collectability during the course of the Company s normal loan review procedures. If the Company deems a participation loan impaired, it applies the same accounting policies and procedures described under Critical Accounting Policies Allowance for Loan Losses .

The average yield earned on loans and loans held for sale was 5.10% in the first six months of 2015 and 5.07% in the first six months of 2014.

The specific economic and credit risks associated with our loan portfolio include, but are not limited to, the effects of current economic conditions on our borrowers cash flows, real estate market sales volumes, valuations, availability and cost of financing properties, real estate industry concentrations, deterioration in certain credits, interest rate fluctuations, reduced collateral values or non-existent collateral, title defects, inaccurate appraisals, financial deterioration of borrowers, fraud, and any violation of applicable laws and regulations.

The Company attempts to reduce these economic and credit risks by adhering to loan to value guidelines for collateralized loans, investigating the creditworthiness of borrowers and monitoring borrowers financial position. Also, we have established and periodically review, lending policies and procedures. Banking regulations limit a bank s credit exposure by prohibiting unsecured loan relationships that exceed 10% of its capital accounts; or 20% of capital accounts, if loans in excess of 10% are fully secured. Under these regulations, we are prohibited from having secured loan relationships in excess of approximately $17.1 million. Furthermore, we have an internal limit for aggregate credit exposure (loans outstanding plus unfunded commitments) to a single borrower of $15.4 million. Our loan policy requires that the Loan Committee of the Board of Directors approve any loan relationships that exceed this internal limit. At June 30, 2015, the Bank had no loan relationships exceeding these limits.

We periodically analyze our commercial loan portfolio to determine if a concentration of credit risk exists in any one or more industries. We use classification systems broadly accepted by the financial services industry in order to categorize our commercial borrowers. Loan concentrations to borrowers in the following classes exceeded 25% of the Bank s total risk-based capital at June 30, 2015 (and related balances at December 31, 2014).

(In thousands)	**June 30, 2015**	**December 31, 2014**
Lessors of 1 to 4 family residential properties	$ 45,591	$ 41,152
Multi-family residential properties	36,298	35,961
Shopping centers	30,898	30,016

Allowance for Loan Losses

The Company maintains the allowance for loan losses at a level that management believes appropriate to adequately cover the Company s estimate of probable losses inherent in the loan portfolio. At June 30, 2015 and December 31, 2014, the allowance for loan losses was $4.9 million and $4.8 million, respectively, which management believed to be adequate at each of the respective dates. The judgments and estimates associated with the determination of the allowance for loan losses are described under Critical Accounting Policies.

A summary of the changes in the allowance for loan losses and certain asset quality ratios for the second quarter of 2015 and the previous four quarters is presented below.

		2015			2014	
		Second	**First**	**Fourth**	**Third**	**Second**
(Dollars in thousands)		**Quarter**	**Quarter**	**Quarter**	**Quarter**	**Quarter**
Balance at beginning of period	$	4,722	4,836	4,754	4,728	4,711
Charge-offs:						
Commercial and industrial			(58)			(46)
Construction and land development				1		
Residential real estate			(60)	(79)	(287)	(41)
Consumer installment		(5)	(17)	(6)	(39)	(8)
Total charge-offs		(5)	(135)	(84)	(326)	(95)
Recoveries		169	21	16	52	112
Net recoveries (charge-offs)		164	(114)	(68)	(274)	17
Provision for loan losses				150	300	
Ending balance	$	4,886	4,722	4,836	4,754	4,728
as a % of loans		1.20 %	1.19	1.20	1.20	1.23
as a % of nonperforming loans		360 %	377	433	281	169
Net (recoveries) charge-offs as % of average loans (a)		(0.16)%	0.11	0.07	0.28	(0.02)

(a) Net (recoveries) charge-offs are annualized.

As described under Critical Accounting Policies, management assesses the adequacy of the allowance prior to the end of each calendar quarter. The level of the allowance is based upon management s evaluation of the loan portfolios, past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower s ability to repay (including the timing of future payment), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, industry and peer bank loan loss rates, and other pertinent factors. This evaluation is inherently subjective as it requires various material estimates and judgments, including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. The ratio of our allowance for loan losses to total loans outstanding was 1.20% at June 30, 2015 and December 31, 2014. In the future, the allowance to total loans outstanding ratio will increase or decrease to the extent the factors that influence our quarterly allowance assessment in their entirety either improve or weaken. In addition, our regulators, as an integral part of their examination process, will periodically review the Company s allowance for loan losses, and may require the Company to make additional provisions to the allowance for loan losses based on their judgement about information available to them at the time of their examinations.

Net recoveries were $50,000, or 0.02% of average loans in the first six months of 2015, compared to net charge-offs of $140,000, or 0.07% of average loans in the first six months of 2014. In the first six months of 2015, the Company recovered $140,000 related to the full repayment of a B note that was previously charged-off as part of a troubled debt restructuring.

At June 30, 2015, the ratio of our allowance for loan losses as a percentage of nonperforming loans was 360%, compared to 433% at December 31, 2014.

At June 30, 2015 and December 31, 2014, the Company s recorded investment in loans considered impaired was $2.3 million and $3.3 million, respectively, with corresponding valuation allowances (included in the allowance for loan losses) of $0.5 million and $0.2 million at each respective date.

Nonperforming Assets

At June 30, 2015 and December 31, 2014, respectively, the Company had $1.9 million and $1.7 million in nonperforming assets.

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The table below provides information concerning total nonperforming assets and certain asset quality ratios for the second quarter of 2015 and the previous four quarters.

		2015			2014	
(Dollars in thousands)		Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter
Nonperforming assets:						
Nonaccrual loans	$	1,359	1,251	1,117	1,690	2,804
Other real estate owned		499	499	534	1,215	1,584
Total nonperforming assets	$	1,858	1,750	1,651	2,905	4,388
as a % of loans and other real estate owned		0.45 %	0.44	0.41	0.73	1.13
as a % of total assets		0.23 %	0.22	0.21	0.37	0.57
Nonperforming loans as a % of total loans		0.33 %	0.32	0.28	0.43	0.73
Accruing loans 90 days or more past due	$	442	2		76	71

The table below provides information concerning the composition of nonaccrual loans for the second quarter of 2015 and the previous four quarters.

		2015			2014	
(In thousands)		Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter
Nonaccrual loans:						
Commercial and industrial	$	46	51	55	56	52
Construction and land development		602	618	605	615	963
Commercial real estate		684	405	263	482	486
Residential real estate		27	177	194	533	1,303
Consumer installment					4	
Total nonaccrual loans	$	1,359	1,251	1,117	1,690	2,804

The Company discontinues the accrual of interest income when (1) there is a significant deterioration in the financial condition of the borrower and full repayment of principal and interest is not expected or (2) the principal or interest is 90 days or more past due, unless the loan is both well-secured and in the process of collection. At June 30, 2015 and December 31, 2014, respectively, the Company had $1.4 million and $1.1 million in loans on nonaccrual.

At June 30, 2015, there were $0.4 million in loans 90 days or more past due and still accruing interest compared to none at December 31, 2014.

The table below provides information concerning the composition of other real estate owned for the second quarter of 2015 and the previous four quarters.

	2015		2014		
(In thousands)	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter
Other real estate owned:					
Commercial:					
Developed lots	252	252	252	882	1,260
Residential	247	247	282	333	324
Total other real estate owned	$ 499	499	534	1,215	1,584

At June 30, 2015 and December 31, 2014, respectively, the Company held $0.5 million in OREO, which we acquired from borrowers.

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Potential Problem Loans

Potential problem loans represent those loans with a well-defined weakness and where information about possible credit problems of a borrower have caused management to have serious doubts about the borrower s ability to comply with present repayment terms. This definition is believed to be substantially consistent with the standards established by the Federal Reserve, the Company s primary regulator, for loans classified as substandard, excluding nonaccrual loans. Potential problem loans, which are not included in nonperforming assets, amounted to $6.6 million, or 1.6% of total loans at June 30, 2015, compared to $7.8 million, or 2.0% of total loans at December 31, 2014.

The table below provides information concerning the composition of potential problem loans for the second quarter of 2015 and the previous four quarters.

		2015			2014	
(In thousands)		**Second Quarter**	**First Quarter**	**Fourth Quarter**	**Third Quarter**	**Second Quarter**
Potential problem loans:						
Commercial and industrial	$	383	385	376	429	397
Construction and land development		627	768	556	567	575
Commercial real estate		503	880	884	887	975
Residential real estate		4,898	5,682	5,917	5,898	4,754
Consumer installment		167	112	114	116	111
Total potential problem loans	$	6,578	7,827	7,847	7,897	6,812

At June 30, 2015, approximately $0.3 million, or 4.7%, of total potential problem loans were past due at least 30 days, but less than 90 days. At June 30, 2015, the remaining balance of potential problem loans were current or past due less than 30 days.

The following table is a summary of the Company s performing loans that were past due at least 30 days, but less than 90 days, for the second quarter of 2015 and the previous four quarters.

	2015			2014	
(In thousands)	**Second Quarter**	**First Quarter**	**Fourth Quarter**	**Third Quarter**	**Second Quarter**
Performing loans past due					

30 to 89 days:						
Commercial and industrial	$	6	82	168	245	277
Construction and land development		12	319	210	190	192
Commercial real estate				201	203	
Residential real estate		415	1,417	2,231	221	832
Consumer installment		23	25	45	59	110
Total	$	456	1,843	2,855	918	1,411

Deposits

Total deposits were $716.0 million at June 30, 2015, compared to $693.4 million at December 31, 2014. Noninterest bearing deposits were $149.7 million, or 20.9% of total deposits, at June 30, 2015, compared to $130.2 million, or 18.8% of total deposits at December 31, 2014.

The average rate paid on total interest-bearing deposits was 0.76% in the first six months of 2015 and 0.91% in the first six months of 2014.

Other Borrowings

Other borrowings consist of short-term borrowings and long-term debt. Short-term borrowings consist of federal funds purchased and securities sold under agreements to repurchase with an original maturity less than one year. The Bank had available federal funds lines totaling $41.0 million with none outstanding at June 30, 2015, compared to $38.0 million and none outstanding at December 31, 2014. Securities sold under agreements to repurchase totaled $2.9 million and $4.7 million at June 30, 2015 and December 31, 2014, respectively.

The average rate paid on short-term borrowings was 0.48% in the first six months of 2015 and 0.53% in the first six months of 2014.

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Long-term debt includes FHLB advances with an original maturity greater than one year and subordinated debentures related to trust preferred securities. The Bank had no long-term FHLB advances outstanding at June 30, 2015, compared to $5.0 million at December 31, 2014. In March 2015, the Bank repaid a $5.0 million FHLB advance and incurred prepayment penalties of $0.4 million. At both June 30, 2015 and December 31, 2014, the Bank had $7.2 million in junior subordinated debentures related to trust preferred securities outstanding. The debentures mature on December 31, 2033 and have been redeemable since December 31, 2008.

The average rate paid on long-term debt was 3.53% in the first six months of 2015 and 3.43% in the first six months of 2014.

CAPITAL ADEQUACY

The Company s consolidated stockholders equity was $77.1 million and $75.8 million as of June 30, 2015 and December 31, 2014, respectively. The change from December 31, 2014 was primarily driven by net earnings of $4.0 million, partially offset by cash dividends paid of $1.6 million and an other comprehensive loss due to the change in unrealized gains (losses) on securities available-for-sale, net-of-tax, of $1.2 million.

The Company s tier 1 leverage ratio was 10.39%, common equity tier 1 (CET1) risk-based capital ratio was 15.42%, tier 1 risk-based capital ratio was 16.76%, and total risk-based capital ratio was 17.78% at June 30, 2015. These ratios exceed the minimum regulatory capital percentages of 5.0% for tier 1 leverage ratio, 6.5% for CET1 risk-based capital ratio, 8.0% for tier 1 risk-based capital ratio, and 10.0% for total risk-based capital ratio to be considered well capitalized. Based on current regulatory standards, the Company is classified as well capitalized.

MARKET AND LIQUIDITY RISK MANAGEMENT

Management s objective is to manage assets and liabilities to provide a satisfactory, consistent level of profitability within the framework of established liquidity, loan, investment, borrowing, and capital policies. The Bank s Asset Liability Management Committee (ALCO) is charged with the responsibility of monitoring these policies, which are designed to ensure an acceptable asset/liability composition. Two critical areas of focus for ALCO are interest rate risk and liquidity risk management.

Interest Rate Risk Management

In the normal course of business, the Company is exposed to market risk arising from fluctuations in interest rates. ALCO measures and evaluates interest rate risk so that the Bank can meet customer demands for various types of loans and deposits. Measurements used to help manage interest rate sensitivity include an earnings simulation model and an economic value of equity (EVE) model.

Earnings simulation. Management believes that interest rate risk is best estimated by our earnings simulation modeling. Forecasted levels of earning assets, interest-bearing liabilities, and off-balance sheet financial instruments are combined with ALCO forecasts of market interest rates for the next 12 months and other factors in order to produce various earnings simulations and estimates. To help limit interest rate risk, we have guidelines for earnings at risk which seek to limit the variance of net interest income from gradual changes in interest rates. For changes up or down in rates from management s flat interest rate forecast over the next 12 months, policy limits for net interest income variances are as follows:

+/- 20% for a gradual change of 400 basis points
+/- 15% for a gradual change of 300 basis points
+/- 10% for a gradual change of 200 basis points
+/- 5% for a gradual change of 100 basis points

At June 30, 2015, our earnings simulation model indicated that we were in compliance with the policy guidelines noted above.

Economic Value of Equity. EVE measures the extent that the estimated economic values of our assets, liabilities, and off-balance sheet items will change as a result of interest rate changes. Economic values are estimated by discounting expected cash flows from assets, liabilities, and off-balance sheet items, which establishes a base case EVE. In contrast with our earnings simulation model, which evaluates interest rate risk over a 12 month timeframe, EVE uses a terminal horizon which allows for the re-pricing of all assets, liabilities, and off-balance sheet items. Further, EVE is measured using values as of a point in time and does not reflect any actions that ALCO might take in responding to or anticipating changes in interest rates, or market and competitive conditions. To help limit interest rate risk, we have stated policy guidelines for an instantaneous basis point change in interest rates, such that our EVE should not decrease from our base case by more than the following:

45% for an instantaneous change of +/- 400 basis points
35% for an instantaneous change of +/- 300 basis points
25% for an instantaneous change of +/- 200 basis points
15% for an instantaneous change of +/- 100 basis points

At June 30, 2015, our EVE model indicated that we were in compliance with the policy guidelines noted above.

Each of the above analyses may not, on its own, be an accurate indicator of how our net interest income will be affected by changes in interest rates. Income associated with interest-earning assets and costs associated with interest-bearing liabilities may not be affected uniformly by changes in interest rates. In addition, the magnitude and duration of changes in interest rates may have a significant impact on net interest income. For example, although certain assets and liabilities may have similar maturities or periods of repricing, they may react in different degrees to changes in market interest rates, and other economic and market factors, including market perceptions. Interest rates on certain types of assets and liabilities fluctuate in advance of changes in general market rates, while interest rates on other types of assets and liabilities may lag behind changes in general market rates. In addition, certain assets, such as adjustable rate mortgage loans, have features (generally referred to as interest rate caps and floors) which limit changes in interest rates. Prepayment and early withdrawal levels also could deviate significantly from those assumed in calculating the maturity of certain instruments. The ability of many borrowers to service their debts also may decrease during periods of rising interest rates or economic stress, which may differ across industries and economic sectors. ALCO reviews each of the above interest rate sensitivity analyses along with several different interest rate scenarios in seeking satisfactory, consistent levels of profitability within the framework of the Company s established liquidity, loan, investment, borrowing, and capital policies.

The Company may also use derivative financial instruments to improve the balance between interest-sensitive assets and interest-sensitive liabilities, and as a tool to manage interest rate sensitivity while continuing to meet the credit and deposit needs of our customers. From time to time, the Company may enter into interest rate swaps (swaps) to facilitate customer transactions and meet their financing needs. These swaps qualify as derivatives, but are not designated as hedging instruments. At June 30, 2015 and December 31, 2014, the Company had no derivative contracts designated as part of a hedging relationship to assist in managing its interest rate sensitivity.

Liquidity Risk Management

Liquidity is the Company s ability to convert assets into cash equivalents in order to meet daily cash flow requirements, primarily for deposit withdrawals, loan demand and maturing obligations. Without proper management of its liquidity, the Company could experience higher costs of obtaining funds due to insufficient liquidity, while excessive liquidity can lead to a decline in earnings due to the cost of foregoing alternative higher-yielding investment opportunities.

Liquidity is managed at two levels. The first is the liquidity of the Company. The second is the liquidity of the Bank. The management of liquidity at both levels is essential, because the Company and the Bank are separate legal entities with different funding needs and sources, and each are subject to regulatory guidelines and requirements.

The primary source of funding and the primary source of liquidity for the Company include dividends received from the Bank, and secondarily proceeds from the possible issuance of common stock or other securities. Primary uses of funds by the Company include dividends paid to stockholders, stock repurchases, and interest payments on junior subordinated debentures issued by the Company in connection with trust preferred securities. The junior subordinated debentures are presented as long-term debt in the accompanying consolidated balance sheets and the related trust preferred securities are currently includible in Tier 1 Capital for regulatory capital purposes.

Primary sources of funding for the Bank include customer deposits, other borrowings, repayment and maturity of securities, sales of securities, and the sale and repayment of loans. The Bank has access to federal funds lines from various banks and borrowings from the Federal Reserve discount window. In addition to these sources, the Bank may participate in the FHLB s advance program to obtain funding for its growth. Advances include both fixed and variable terms and may be taken out with varying maturities. At June 30, 2015, the Bank had a remaining available line of credit with the FHLB of $232.3 million. At June 30, 2015, the Bank also had $41.0 million of available federal funds lines with none outstanding. Primary uses of funds include repayment of maturing obligations and growing the loan portfolio.

Management believes that the Company and the Bank have adequate sources of liquidity to meet all known contractual obligations and unfunded commitments, including loan commitments and reasonable borrower, depositor, and creditor requirements over the next twelve months.

Off-Balance Sheet Arrangements, Commitments and Contingencies

At June 30, 2015, the Bank had outstanding standby letters of credit of $8.2 million and unfunded loan commitments outstanding of $49.4 million. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements. If needed to fund these outstanding commitments, the Bank could liquidate federal funds sold or a portion of securities available-for-sale, or draw on its available credit facilities.

Mortgage lending activities

Since 2009, we have primarily sold residential mortgage loans in the secondary market to Fannie Mae while retaining the servicing of these loans. The sale agreements for these residential mortgage loans with Fannie Mae and other investors include various representations and warranties regarding the origination and characteristics of the residential mortgage loans. Although the representations and warranties vary among investors, they typically cover ownership of the loan, validity of the lien securing the loan, the absence of delinquent taxes or liens against the property securing the loan, compliance with loan criteria set forth in the applicable agreement, compliance with applicable federal, state, and local laws, among other matters.

As of June 30, 2015, the unpaid principal balance of residential mortgage loans, which we have originated and sold, but retained the servicing rights was $357.1 million. Although these loans are generally sold on a non-recourse basis, we may be obligated to repurchase residential mortgage loans or reimburse investors for losses incurred (make whole requests) if a loan review reveals a potential breach of seller representations and warranties. Upon receipt of a repurchase or make whole request, we work with investors to arrive at a mutually agreeable resolution. Repurchase and make whole requests are typically reviewed on an individual loan by loan basis to validate the claims made by the investor and to determine if a contractually required repurchase or make whole event has occurred. We seek to reduce and manage the risks of potential repurchases, make whole requests, or other claims by mortgage loan investors through our underwriting and quality assurance practices and by servicing mortgage loans to meet investor and secondary market standards.

In the first six months of 2015, as a result of the representation and warranty provisions contained in the Company s sale agreements with Fannie Mae, the Company was required to repurchase one loan with a principal balance of $169,000 that was current as to principal and interest and reimburse Fannie Mae approximately $37,000 related to a make whole request. At June 30, 2015, the Company had no pending repurchase or make whole requests.

Also, in the first quarter of 2015, the Company voluntarily repurchased ten investment property loans with an aggregate principal balance of $4.0 million that were made to the same borrower and were current as to principal and interest. At the date of repurchase, the aggregate fair value of these ten investment property loans was greater than the repurchase price required by Fannie Mae. As part of its quality control review procedures, one of these ten loans was self-reported to Fannie Mae in 2014 for possible breaches related to representation and warranty provisions. After further investigation, the Company identified certain underwriting deficiencies for nine additional investment property loans that were related to the same borrower. All ten loans were originated and sold to Fannie Mae. The Company submitted a voluntary repurchase request to Fannie Mae in January 2015 for all ten investment property loans, which was approved. In response to the quality control review findings related to this one borrower, the Company has put additional controls in place for investment property loans originated for sale, including additional quality control reviews and management approvals. Furthermore, management performed additional reviews of investment property loans originated for sale, including a review of the number of loans to one borrower, and does not believe there is any material exposure related to representation and warranty provisions for these loans.

We service all residential mortgage loans originated and sold by us to Fannie Mae. As servicer, our primary duties are to: (1) collect payments due from borrowers; (2) advance certain delinquent payments of principal and interest; (3) maintain and administer any hazard, title, or primary mortgage insurance policies relating to the mortgage loans; (4) maintain any required escrow accounts for payment of taxes and insurance and administer escrow payments; and (5) foreclose on defaulted mortgage loans or take other actions to mitigate the potential losses to investors consistent with the agreements governing our rights and duties as servicer.

The agreement under which we act as servicer generally specifies a standard of responsibility for actions taken by us in such capacity and provides protection against expenses and liabilities incurred by us when acting in compliance with the respective servicing agreements. However, if we commit a material breach of our obligations as servicer, we may be subject to termination if the breach is not cured within a specified period following notice. The standards governing servicing and the possible remedies for violations of such standards are determined by servicing guides issued by Fannie Mae as well as the contract provisions established between Fannie Mae and the Bank. Remedies could include repurchase of an affected loan.

Although repurchase and make whole requests related to representation and warranty provisions and servicing activities have been limited to date, it is possible that requests to repurchase mortgage loans or reimburse investors for losses incurred (make whole requests) may increase in frequency if investors more aggressively pursue all means of recovering losses on their purchased loans. As of June 30, 2015, we do not believe that this exposure is material due to the historical level of repurchase requests and loss trends, in addition to the fact that 99% of our residential mortgage loans serviced for Fannie Mae were current as of such date. We maintain ongoing communications with our investors and will continue to evaluate this exposure by monitoring the level and number of repurchase requests as well as the delinquency rates in our investor portfolios.

Effects of Inflation and Changing Prices

The Consolidated Financial Statements and related consolidated financial data presented herein have been prepared in accordance with U.S. generally accepted accounting principles and practices within the banking industry which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution s performance than the effects of general levels of inflation.

CURRENT ACCOUNTING DEVELOPMENTS

The following Accounting Standards Updates (Updates or ASUs) have been issued by the FASB but are not yet effective.

ASU 2014-09, *Revenue from Contracts with Customers (Topic 606);*

ASU 2015-02, *Amendments to the Consolidation Analysis (Topic 810); and*

ASU 2015-05, *Customer s Accounting for Fees Paid in a Cloud Computing Arrangement and Disclosures of Disposals of Components of an Entity.*

Information about these pronouncements is described in more detail below.

ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, provides a comprehensive and converged standard on revenue recognition. The new guidance is intended to improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects consideration to which the entity expects to be entitled in exchange for those goods and services. This guidance also requires new qualitative and quantitative disclosures related to revenue from contracts with customers. These changes are effective for the Company in the first quarter 2017 with retrospective application to each prior reporting period or with the cumulative effect of initially applying this Update at the date of initial application. Early adoption is not permitted. The Company is currently evaluating the impact this ASU will have on its consolidated financial statements.

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ASU 2015-02, *Amendments to the Consolidation Analysis (Topic 810)*, affects reporting entities that are required to evaluate whether they should consolidate certain legal entities. Specifically, the amendments: (1) Modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities; (2) Eliminate the presumption that a general partner should consolidate a limited partnership; (3) Affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships; and (4) Provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. These changes are effective for the Company in the first quarter of 2016. Early adoption is permitted. The Company is currently evaluating the impact this ASU will have on its consolidated financial statements.

ASU 2015-05, *Customer s Accounting for Fees Paid in a Cloud Computing Arrangement*, provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The new guidance does not change the accounting for a customer s accounting for service contracts. These changes are effective for the Company in the first quarter of 2016. Early adoption is permitted. The Company is currently evaluating the impact this ASU will have on its consolidated financial statements.

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Table 1 Explanation of Non-GAAP Financial Measures

In addition to results presented in accordance with U.S. generally accepted accounting principles (GAAP), this quarterly report on Form 10-Q includes certain designated net interest income amounts presented on a tax-equivalent basis, a non-GAAP financial measure, including the presentation and calculation of the efficiency ratio.

The Company believes the presentation of net interest income on a tax-equivalent basis provides comparability of net interest income from both taxable and tax-exempt sources and facilitates comparability within the industry. Although the Company believes these non-GAAP financial measures enhance investors understanding of its business and performance, these non-GAAP financial measures should not be considered an alternative to GAAP. The reconciliations of these non-GAAP financial measures to their most directly comparable GAAP financial measures are presented below.

		2015		2014		
(In thousands)		**Second Quarter**	**First Quarter**	**Fourth Quarter**	**Third Quarter**	**Second Quarter**
Net interest income (GAAP)	**$**	**5,788**	**5,523**	**5,482**	**5,448**	**5,253**
Tax-equivalent adjustment		338	335	331	321	312
Net interest income (Tax-equivalent)	**$**	**6,126**	**5,858**	**5,813**	**5,769**	**5,565**

		Six Months Ended June 30,	
(In thousands)		**2015**	**2014**
Net interest income (GAAP)	**$**	**11,311**	**10,523**
Tax-equivalent adjustment		673	636
Net interest income (Tax-equivalent)	**$**	**11,984**	**11,159**

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Table 2 - Selected Quarterly Financial Data

(Dollars in thousands, except per share amounts)	2015 Second Quarter	2015 First Quarter	2014 Fourth Quarter	2014 Third Quarter	2014 Second Quarter
Results of Operations					
Net interest income (a)	$ 6,126	5,858	5,813	5,769	5,565
Less: tax-equivalent adjustment	338	335	331	321	312
Net interest income (GAAP)	5,788	5,523	5,482	5,448	5,253
Noninterest income	1,167	1,321	1,079	1,017	1,081
Total revenue	6,955	6,844	6,561	6,465	6,334
Provision for loan losses			150	300	
Noninterest expense	4,029	4,314	3,780	3,584	3,792
Income tax expense	776	668	735	709	683
Net earnings	$ 2,150	1,862	1,896	1,872	1,859
Per share data:					
Basic and diluted net earnings	$ 0.59	0.51	0.52	0.51	0.51
Cash dividends declared	0.22	0.22	0.215	0.215	0.215
Weighted average shares outstanding:					
Basic and diluted	3,643,413	3,643,365	3,643,328	3,643,328	3,643,295
Shares outstanding	3,643,428	3,643,378	3,643,328	3,643,328	3,643,328
Book value	$ 21.15	21.28	20.80	20.09	19.84
Common stock price					
High	$ 25.75	25.25	24.64	24.92	25.00
Low	24.51	23.15	22.10	23.17	22.90
Period end	25.73	24.85	23.64	24.64	24.02
To earnings ratio	12.08x	12.12	11.59	12.38	12.19
To book value	122%	117	114	123	121
Performance ratios:					
Return on average equity	10.91%	9.68	10.21	10.19	10.72
Return on average assets	1.09%	0.93	0.98	0.97	0.96
Dividend payout ratio	37.29%	43.14	41.35	42.16	42.16
Asset Quality:					
Allowance for loan losses as a % of:					
Loans	1.20%	1.19	1.20	1.20	1.23
Nonperforming loans	360%	377	433	281	169
Nonperforming assets as a % of:					
Loans and other real estate owned	0.45%	0.44	0.41	0.73	1.13
Total assets	0.23%	0.22	0.21	0.37	0.57

Nonperforming loans as a % of total loans	0.33%	0.32	0.28	0.43	0.73
Net (recoveries) charge-offs as a % of average loans (c)	(0.16)%	0.11	0.07	0.28	(0.02)
Capital Adequacy:					
CET 1 risk-based capital ratio	15.42%	15.38	n/a	n/a	n/a
Tier 1 risk-based capital ratio	16.76%	16.83	17.45	17.43	17.45
Total risk-based capital ratio	17.78%	17.84	18.54	18.50	18.53
Tier 1 Leverage Ratio	10.39%	10.13	10.32	10.26	10.07
Other financial data:					
Net interest margin (a)	3.29%	3.15	3.14	3.16	3.09
Effective income tax rate	26.52%	26.40	27.94	27.47	26.87
Efficiency ratio (b)	55.24%	60.09	54.85	52.81	57.06
Selected average balances:					
Securities	$ 259,376	264,268	265,616	274,155	274,305
Loans, net of unearned income	402,482	400,161	397,875	389,392	378,994
Total assets	791,889	802,062	777,548	771,685	772,326
Total deposits	699,453	705,746	682,812	678,738	684,613
Long-term debt	7,217	11,550	12,217	12,217	12,217
Total stockholders equity	78,791	76,915	74,307	73,499	69,367
Selected period end balances:					
Securities	$ 252,906	262,141	267,603	264,827	276,953
Loans, net of unearned income	408,495	396,613	402,954	394,602	385,826
Allowance for loan losses	4,886	4,722	4,836	4,754	4,728
Total assets	806,233	790,224	789,231	781,136	775,128
Total deposits	715,994	698,336	693,390	680,763	684,181
Long-term debt	7,217	7,217	12,217	12,217	12,217
Total stockholders equity	77,053	77,544	75,799	73,193	72,291

(a) Tax-equivalent. See Table 1 - Explanation of Non-GAAP Financial Measures.

(b) Efficiency ratio is the result of noninterest expense divided by the sum of noninterest income and tax-equivalent net interest income.

(c) Net (recoveries) charge-offs are annualized.

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Table 3 - Selected Financial Data

(Dollars in thousands, except per share amounts)		Six Months Ended June 30, 2015	2014
Results of Operations			
Net interest income (a)	$	11,984	11,159
Less: tax-equivalent adjustment		673	636
Net interest income (GAAP)		11,311	10,523
Noninterest income		2,488	1,837
Total revenue		13,799	12,360
Provision for loan losses			(400)
Noninterest expense		8,343	7,740
Income tax expense		1,444	1,340
Net earnings	$	4,012	3,680
Per share data:			
Basic and diluted net earnings	$	1.10	1.01
Cash dividends declared		0.44	0.43
Weighted average shares outstanding:			
Basic and diluted		3,643,389	3,643,228
Shares outstanding, at period end		3,643,428	3,643,328
Book value	$	21.15	19.84
Common stock price			
High	$	25.75	25.80
Low		23.15	22.90
Period end		25.73	24.02
To earnings ratio		12.08x	12.19
To book value		122%	121
Performance ratios:			
Return on average equity		10.31%	10.91
Return on average assets		1.01%	0.96
Dividend payout ratio		40.00%	42.57
Asset Quality:			
Allowance for loan losses as a % of:			
Loans		1.20%	1.23
Nonperforming loans		360%	169
Nonperforming assets as a % of:			
Loans and other real estate owned		0.45%	1.13
Total assets		0.23%	0.57
Nonperforming loans as a % of total loans		0.33%	0.73
Annualized net (recoveries) charge-offs as a % of average loans		(0.02)%	0.07
Capital Adequacy:			
CET 1 risk-based capital ratio		15.42%	n/a
Tier 1 risk-based capital ratio		16.76%	17.45
Total risk-based capital ratio		17.78%	18.53

Tier 1 Leverage Ratio		10.39%	10.07
Other financial data:			
Net interest margin (a)		3.22%	3.14
Effective income tax rate		26.47%	26.69
Efficiency ratio (b)		57.65%	59.56
Selected average balances:			
Securities	$	261,809	271,177
Loans, net of unearned income		401,327	378,163
Total assets		796,947	767,268
Total deposits		702,582	681,487
Long-term debt		9,372	12,217
Total stockholders equity		77,858	67,472
Selected period end balances:			
Securities	$	252,906	276,953
Loans, net of unearned income		408,495	385,826
Allowance for loan losses		4,886	4,728
Total assets		806,233	775,128
Total deposits		715,994	684,181
Long-term debt		7,217	12,217
Total stockholders equity		77,053	72,291

(a) Tax-equivalent. See Table 1 - Explanation of Non-GAAP Financial Measures.

(b) Efficiency ratio is the result of noninterest expense divided by the sum of noninterest income and tax-equivalent net interest income.

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Table 4 - Average Balances and Net Interest Income Analysis

	Quarter ended June 30,					
	2015			2014		
(Dollars in thousands)	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
Interest-earning assets:						
Loans and loans held for sale (1)	$ 405,093	$ 5,217	5.17%	$ 382,100	$ 4,766	5.00%
Securities - taxable	191,181	949	1.99%	213,777	1,214	2.28%
Securities - tax-exempt (2)	68,195	992	5.83%	60,528	919	6.09%
Total securities	259,376	1,941	3.00%	274,305	2,133	3.12%
Federal funds sold	47,215	28	0.24%	63,604	30	0.19%
Interest bearing bank deposits	35,370	23	0.26%	2,670		
Total interest-earning assets	747,054	$ 7,209	3.87%	722,679	$ 6,929	3.85%
Cash and due from banks	13,083			12,690		
Other assets	31,752			36,957		
Total assets	$ 791,889			$ 772,326		
Interest-bearing liabilities:						
Deposits:						
NOW	$ 114,803	$ 88	0.31%	$ 107,287	$ 86	0.32%
Savings and money market	202,309	183	0.36%	190,057	243	0.51%
Certificates of deposits less than $100,000	92,423	238	1.03%	103,518	305	1.18%
Certificates of deposits and other time deposits of $100,000 or more	142,526	511	1.44%	157,585	621	1.58%
Total interest-bearing deposits	552,061	1,020	0.74%	558,447	1,255	0.90%
Short-term borrowings	3,678	4	0.44%	3,404	5	0.59%
Long-term debt	7,217	59	3.28%	12,217	104	3.41%
Total interest-bearing liabilities	562,956	$ 1,083	0.77%	574,068	$ 1,364	0.95%
	147,392			126,166		

Noninterest-bearing deposits						
Other liabilities	2,750			2,725		
Stockholders equity	78,791			69,367		
Total liabilities and stockholders equity	$ 791,889			$ 772,326		
Net interest income and margin (tax-equivalent)		$ 6,126	3.29%		$ 5,565	3.09%

(1) Average loan balances are shown net of unearned income and loans on nonaccrual status have been included in the computation of average balances.

(2) Yields on tax-exempt securities have been computed on a tax-equivalent basis using an income tax rate of 34%.

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Table 5 - Average Balances and Net Interest Income Analysis

	Six Months Ended June 30,					
	2015			2014		
(Dollars in thousands)	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
Interest-earning assets:						
Loans and loans held for sale (1)	$ 404,106	$ 10,223	5.10%	$ 380,449	$ 9,556	5.07%
Securities - taxable	193,694	1,989	2.07%	210,223	2,390	2.29%
Securities - tax-exempt (2)	68,115	1,978	5.86%	60,954	1,870	6.19%
Total securities	261,809	3,967	3.06%	271,177	4,260	3.17%
Federal funds sold	60,789	62	0.21%	59,385	55	0.19%
Interest bearing bank deposits	24,449	28	0.23%	5,171	17	0.66%
Total interest-earning assets	751,153	$ 14,280	3.83%	716,182	$ 13,888	3.91%
Cash and due from banks	13,439			12,762		
Other assets	32,355			38,324		
Total assets	$ 796,947			$ 767,268		
Interest-bearing liabilities:						
Deposits:						
NOW	$ 114,739	$ 174	0.31%	$ 106,812	$ 170	0.32%
Savings and money market	207,027	409	0.40%	189,830	480	0.51%
Certificates of deposits less than $100,000	93,933	492	1.06%	104,079	617	1.20%
Certificates of deposits and other time deposits of $100,000 or more	145,124	1,047	1.45%	157,509	1,245	1.59%
Total interest-bearing deposits	560,823	2,122	0.76%	558,230	2,512	0.91%
Short-term borrowings	4,167	10	0.48%	3,440	9	0.53%
Long-term debt	9,372	164	3.53%	12,217	208	3.43%
Total interest-bearing liabilities	574,362	$ 2,296	0.81%	573,887	$ 2,729	0.96%

Noninterest-bearing deposits	141,759			123,257		
Other liabilities	2,968			2,652		
Stockholders equity	77,858			67,472		
Total liabilities and stockholders equity	$ 796,947			$ 767,268		
Net interest income and margin (tax-equivalent)		$ 11,984	3.22%		$ 11,159	3.14%

(1) Average loan balances are shown net of unearned income and loans on nonaccrual status have been included in the computation of average balances.
(2) Yields on tax-exempt securities have been computed on a tax-equivalent basis using an income tax rate of 34%.

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Table 6 - Loan Portfolio Composition

	2015		2014		
(In thousands)	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter
Commercial and industrial	$ 57,310	52,536	54,329	52,868	52,054
Construction and land development	38,854	37,925	37,298	34,189	32,461
Commercial real estate	184,124	182,871	192,006	190,077	187,241
Residential real estate	115,039	111,265	107,641	106,555	102,921
Consumer installment	13,632	12,478	12,335	11,535	11,686
Total loans	408,959	397,075	403,609	395,224	386,363
Less: unearned income	(464)	(462)	(655)	(622)	(537)
Loans, net of unearned income	408,495	396,613	402,954	394,602	385,826
Less: allowance for loan losses	(4,886)	(4,722)	(4,836)	(4,754)	(4,728)
Loans, net	$ 403,609	391,891	398,118	389,848	381,098

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Table 7 - Allowance for Loan Losses and Nonperforming Assets

		2015		2014		
(Dollars in thousands)		Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter
Allowance for loan losses:						
Balance at beginning of period	$	4,722	4,836	4,754	4,728	4,711
Charge-offs:						
Commercial and industrial			(58)			(46)
Construction and land development				1		
Residential real estate			(60)	(79)	(287)	(41)
Consumer installment		(5)	(17)	(6)	(39)	(8)
Total charge-offs		(5)	(135)	(84)	(326)	(95)
Recoveries		169	21	16	52	112
Net recoveries (charge-offs)		164	(114)	(68)	(274)	17
Provision for loan losses				150	300	
Ending balance	$	4,886	4,722	4,836	4,754	4,728
as a % of loans		1.20 %	1.19	1.20	1.20	1.23
as a % of nonperforming loans		360 %	377	433	281	169
Net (recoveries) charge-offs as % of avg. loans (a)		(0.16)%	0.11	0.07	0.28	(0.02)
Nonperforming assets:						
Nonaccrual loans	$	1,359	1,251	1,117	1,690	2,804
Other real estate owned		499	499	534	1,215	1,584
Total nonperforming assets	$	1,858	1,750	1,651	2,905	4,388
as a % of loans and other real estate owned		0.45 %	0.44	0.41	0.73	1.13
as a % of total assets		0.23 %	0.22	0.21	0.37	0.57
Nonperforming loans as a % of total loans		0.33 %	0.32	0.28	0.43	0.73
Accruing loans 90 days or more past due	$	442	2		76	71

(a) Net (recoveries) charge-offs are annualized.

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Table 8 - Allocation of Allowance for Loan Losses

	2015				2014					
	Second Quarter		First Quarter		Fourth Quarter		Third Quarter		Second Quarter	
(Dollars in thousands)	**Amount**	**%***	**Amount**	**%***	**Amount**	**%***	**Amount**	**%***	**Amount**	**%***
Commercial and industrial	$ 681	14.0	$ 644	13.2	$ 639	13.5	$ 669	13.4	$ 639	13.5
Construction and land development	640	9.4	830	9.6	974	9.2	895	8.7	907	8.4
Commercial real estate	2,146	45.0	1,888	46.1	1,928	47.6	1,935	48.1	1,913	48.5
Residential real estate	1,180	28.1	1,153	28.0	1,119	26.7	1,083	27.0	1,095	26.6
Consumer installment	239	3.3	207	3.1	176	3.1	172	2.9	174	3.0
Total allowance for loan losses	$ 4,886		$ 4,722		$ 4,836		$ 4,754		$ 4,728	

* Loan balance in each category expressed as a percentage of total loans.

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Table 9 - CDs and Other Time Deposits of $100,000 or More

(Dollars in thousands)	**June 30, 2015**
Maturity of:	
3 months or less	$ 22,150
Over 3 months through 6 months	19,576
Over 6 months through 12 months	19,304
Over 12 months	79,425
Total CDs and other time deposits of $100,000 or more	$ 140,455

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information called for by ITEM 3 is set forth in ITEM 2 under the caption MARKET AND LIQUIDITY RISK MANAGEMENT and is incorporated herein by reference.

ITEM 4. CONTROLS AND PROCEDURES

The Company, with the participation of its management, including its Chief Executive Officer and Principal Financial and Accounting Officer, carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based upon that evaluation and as of the end of the period covered by this report, the Company s Chief Executive Officer and Principal Financial and Accounting Officer concluded that the Company s disclosure controls and procedures were effective to allow timely decisions regarding disclosure in its reports that the Company files or submits to the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended. There have been no changes in the Company s internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the normal course of its business, the Company and the Bank are, from time to time, involved in legal proceedings. The Company s and Bank s management believe there are no pending or threatened legal, governmental, or regulatory proceedings that, upon resolution, are expected to have a material adverse effect upon the Company s or the Bank s financial condition or results of operations. See also, Part I, Item 3 of the Company s Annual Report on Form 10-K for the year ended December 31, 2014.

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. RISK FACTORS in the Company s Annual Report on Form 10-K for the year ended December 31, 2014, which could materially affect our business, financial condition or future results. The risks described in our annual report on Form 10-K are not the only the risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, and/or operating results in the future.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

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ITEM 6. EXHIBITS

Exhibit Number	Description
3.1	Certificate of Incorporation of Auburn National Bancorporation, Inc. and all amendments thereto.*
3.2	Amended and Restated Bylaws of Auburn National Bancorporation, Inc., adopted as of November 13, 2007. **
31.1	Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, As Adopted Pursuant To Section 302 of the Sarbanes-Oxley Act of 2002, by E.L. Spencer, Jr., President, Chief Executive Officer and Chairman of the Board.
31.2	Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, As Adopted Pursuant To Section 302 of the Sarbanes-Oxley Act of 2002, by David A. Hedges, Senior Vice President, Controller and Chief Financial Officer (Principal Financial and Accounting Officer).
32.1	Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 of the Sarbanes-Oxley Act of 2002, by E.L. Spencer, Jr., President, Chief Executive Officer and Chairman of the Board.***
32.2	Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 of the Sarbanes-Oxley Act of 2002, by David A. Hedges, Senior Vice President, Controller and Chief Financial Officer (Principal Financial and Accounting Officer).***
101.INS	XBRL Instance Document ****
101.SCH	XBRL Taxonomy Extension Schema Document ****
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document ****
101.LAB	XBRL Taxonomy Extension Label Linkbase Document ****
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document ****
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document ****

* Incorporated by reference from Registrant s Form 10-Q dated September 30, 2002.

** Incorporated by reference from Registrant s Form 10-K dated March 31, 2008.

*** The certifications attached as exhibits 32.1 and 32.2 to this quarterly report on Form 10-Q are furnished to the Securities and Exchange Commission pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

**** Previously filed.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AUBURN NATIONAL BANCORPORATION, INC.
(Registrant)

Date: July 31, 2015

By: /s/ E. L. Spencer, Jr.
E. L. Spencer, Jr.
President, Chief Executive Officer and
Chairman of the Board

Date: July 31, 2015

By: /s/ David A. Hedges
David A. Hedges
SVP, Controller and Chief Financial Officer
(Principal Financial and Accounting Officer)