FARMERS NATIONAL BANC CORP /OH/
Form 10-Q
November 06, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the

Securities Exchange Act of 1934

For the Quarterly period ended September 30, 2014

Commission file number 001-35296

FARMERS NATIONAL BANC CORP.

(Exact name of registrant as specified in its charter)

OHIO (State or other jurisdiction of incorporation or organization)	34-1371693 (I.R.S. Employer Identification No)
20 South Broad Street Canfield, OH (Address of principal executive offices)	44406 (Zip Code)

(330) 533-3341

(Registrant's telephone number, including area code)

Not applicable

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

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

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

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

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

Class	Outstanding at October 31, 2014
Common Stock, No Par Value	18,408,612 shares

CONSOLIDATED BALANCE SHEETS

FARMERS NATIONAL BANC CORP. AND SUBSIDIARIES

(Unaudited)	(In Thousands of Dollars)	
	September 30, 2014	December 31, 2013
ASSETS		
Cash and due from banks	$ 14,719	$ 12,957
Federal funds sold and other	13,575	14,556
TOTAL CASH AND CASH EQUIVALENTS	28,294	27,513
Securities available for sale	404,895	422,985
Loans held for sale	895	158
Loans	646,981	630,684
Less allowance for loan losses	7,333	7,568
NET LOANS	639,648	623,116
Premises and equipment, net	17,243	17,187
Goodwill	6,354	6,354
Other intangibles	3,414	3,989
Bank owned life insurance	16,250	15,908
Other assets	22,746	20,116
TOTAL ASSETS	$ 1,139,739	$ 1,137,326
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	$ 164,071	$ 155,893
Interest-bearing	748,929	759,323
TOTAL DEPOSITS	913,000	915,216
Short-term borrowings	72,032	81,617
Long-term borrowings	18,617	19,822
Other liabilities	14,689	7,664
TOTAL LIABILITIES	1,018,338	1,024,319
Commitments and contingent liabilities		
Stockholders' Equity:		
Common Stock - Authorized 35,000,000 shares; issued 19,031,059	105,992	105,905
Retained earnings	19,350	14,215
Accumulated other comprehensive income (loss)	(615)	(5,465)
Treasury stock, at cost; 471,579 shares in 2014 and 255,079 shares in 2013	(3,326)	(1,648)
TOTAL STOCKHOLDERS' EQUITY	121,401	113,007
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 1,139,739	$ 1,137,326

See accompanying notes

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CONSOLIDATED STATEMENTS OF INCOME

FARMERS NATIONAL BANC CORP. AND SUBSIDIARIES

(Unaudited)	(In Thousands except Per Share Data) For the Three Months Ended September 30, 2014	September 30, 2013	For the Nine Months Ended September 30, 2014	September 30, 2013
INTEREST AND DIVIDEND INCOME				
Loans, including fees	$7,950	$ 7,724	$23,023	$ 23,031
Taxable securities	1,803	1,598	5,512	5,240
Tax exempt securities	605	742	1,900	2,213
Dividends	47	47	142	148
Federal funds sold and other interest income	8	11	17	29
TOTAL INTEREST AND DIVIDEND INCOME	10,413	10,122	30,594	30,661
INTEREST EXPENSE				
Deposits	987	1,136	3,070	3,450
Short-term borrowings	11	13	35	38
Long-term borrowings	130	125	396	318
TOTAL INTEREST EXPENSE	1,128	1,274	3,501	3,806
NET INTEREST INCOME	9,285	8,848	27,093	26,855
Provision for loan losses	425	340	1,055	765
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	8,860	8,508	26,038	26,090
NONINTEREST INCOME				
Service charges on deposit accounts	711	633	1,915	1,648
Bank owned life insurance income	115	337	342	570
Trust fees	1,561	1,368	4,610	4,105
Insurance agency commissions	85	56	255	139
Security gains	1	597	85	853
Retirement plan consulting fees	395	280	1,392	280
Investment commissions	378	173	815	686
Net gains on sale of loans	114	146	250	448
Other operating income	520	583	1,446	1,544
TOTAL NONINTEREST INCOME	3,880	4,173	11,110	10,273
NONINTEREST EXPENSES				
Salaries and employee benefits	5,330	6,475	15,448	17,080
Occupancy and equipment	1,145	1,053	3,395	3,167
State and local taxes	222	327	685	984
Professional fees	648	742	1,814	1,691
Merger related cost	0	9	0	270
Advertising	250	225	727	638
FDIC insurance	184	181	555	538
Intangible amortization	192	214	575	410
Core processing charges	418	353	1,168	1,035
Other operating expenses	1,387	1,347	3,928	4,023
TOTAL NONINTEREST EXPENSES	9,776	10,926	28,295	29,836

INCOME BEFORE INCOME TAXES	2,964	1,755	8,853	6,527
INCOME TAXES	688	143	2,035	1,042
NET INCOME	$2,276	$ 1,612	$6,818	$ 5,485
EARNINGS PER SHARE - basic and diluted	$0.12	$ 0.09	$0.36	$ 0.29

See accompanying notes

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

FARMERS NATIONAL BANC CORP. AND SUBSIDIARIES

(Unaudited)	(In Thousands of Dollars)			
	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
NET INCOME	$2,276	$1,612	$6,818	$5,485
Other comprehensive income (loss):				
Net unrealized holding gains (losses) on available for sale securities	527	(5,939)	7,547	(17,399)
Reclassification adjustment for (gains) losses realized in income	(1)	(597)	(85)	(853)
Net unrealized holding gains (losses)	526	(6,536)	7,462	(18,252)
Income tax effect	(184)	2,286	(2,612)	6,388
Other comprehensive income (loss), net of tax	342	(4,250)	4,850	(11,864)
TOTAL COMPREHENSIVE INCOME (LOSS)	$2,618	$(2,638)	$11,668	$(6,379)

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

FARMERS NATIONAL BANC CORP. AND SUBSIDIARIES

(Unaudited)	(In Thousands of Dollars) Nine Months Ended September 30, 2014	September 30, 2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$6,818	$5,485
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	1,055	765
Depreciation and amortization	1,487	1,410
Net amortization of securities	1,105	2,216
Security gains	(85)	(853)
Loss on sale of other real estate owned	22	30
Bank owned life insurance income	(342)	(353)
Income recognized from death benefit on bank owned life insurance	0	(217)
Origination of loans held for sale	(11,599)	(22,350)
Proceeds from loans held for sale	11,112	25,406
Net gains on sale of loans	(250)	(448)
Net change in other assets and liabilities	(1,006)	3,505
NET CASH FROM OPERATING ACTIVITIES	8,317	14,596
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturities and repayments of securities available for sale	35,868	62,427
Proceeds from sales of securities available for sale	34,169	55,614
Purchases of securities available for sale	(42,496)	(111,696)
Loan originations and payments, net	(17,884)	(25,885)
Proceeds from sale of other real estate owned	64	199
Proceeds from BOLI death benefit	0	328
Proceeds from sale of real estate	0	118
Additions to premises and equipment	(888)	(181)
Purchase of National Associates Inc., net	0	(2,100)
NET CASH FROM INVESTING ACTIVITIES	8,833	(21,176)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net change in deposits	(2,216)	(15,599)
Net change in short-term borrowings	(9,585)	18,357
Repayment of long-term borrowings	(1,205)	(344)
New Federal Home Loan Bank advance borrowings	0	10,000
Cash dividends paid	(1,685)	(1,684)
Net proceeds from issuance of treasury stock	32	0
Acquisition of treasury shares	(1,710)	(1,606)
NET CASH FROM FINANCING ACTIVITIES	(16,369)	9,124
NET CHANGE IN CASH AND CASH EQUIVALENTS	781	2,544
Beginning cash and cash equivalents	27,513	37,759
Ending cash and cash equivalents	$28,294	$40,303

Supplemental cash flow information:		
Interest paid	$3,532	$3,829
Income taxes paid	$1,205	$1,130
Supplemental noncash disclosures:		
Transfer of loans to other real estate	$297	$103
Issuance of stock for NAI acquisition	$0	$1,400
Contingent consideration for NAI acquisition	$0	$920
Security purchases not settled	$3,008	$6,606

See accompanying notes

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Principles of Consolidation:

Farmers National Banc Corp. ("Company") is a one-bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company provides full banking services through its nationally chartered subsidiary, The Farmers National Bank of Canfield ("Bank"). The Company provides trust services through its subsidiary, Farmers Trust Company ("Trust"), and insurance services through the Bank's subsidiary, Farmers National Insurance ("Insurance"). In addition to the Insurance subsidiary, the Bank has created Farmers of Canfield Investment Co. ("Investments"), a new subsidiary with the primary purpose of investing in municipal securities. On July 1, 2013 the Company acquired National Associates, Inc. ("NAI"), a retirement plan consulting firm located in Cleveland, Ohio. As a result of the acquisition the Company now provides retirement consulting services through NAI. The consolidated financial statements include the accounts of the Company, the Bank and its subsidiaries, along with the Trust and NAI. All significant intercompany balances and transactions have been eliminated in the consolidation.

Basis of Presentation:

The unaudited condensed consolidated financial statements have been prepared in conformity with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles ("U.S. GAAP") for complete financial statements. The financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2013 Annual Report to Shareholders included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. The interim consolidated financial statements include all adjustments (consisting of only normal recurring items) that, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the periods presented. The results of operations for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year. Certain items included in the prior period financial statements were reclassified to conform to the current period presentation. There was no effect on net income or total stockholders' equity.

Estimates:

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The allowance for loan losses, deferred tax assets, carrying amount of goodwill and fair values of financial instruments are particularly subject to change.

Segments:

The Company provides a broad range of financial services to individuals and companies in northeastern Ohio. Operations are managed and financial performance is primarily aggregated and reported in three lines of business, the Bank segment, the Trust segment and the Retirement Consulting segment.

Comprehensive Income (Loss):

Comprehensive income (loss) consists of net income and other comprehensive income (loss). Other comprehensive income (loss) consists of unrealized gains and losses on securities available for sale and changes in the funded status of the post-retirement health plan, which are recognized as separate components of equity, net of tax effects. For the three and nine month periods ended September 30, 2014, there was no change in the funded status of the post-retirement health plan.

Newly Issued but Not Yet Effective Accounting Standards:

In May 2014, FASB issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers (Topic 606). The ASU creates a new topic, Topic 606, to provide guidance on revenue recognition for entities that enter into contracts with customers to transfer goods or services or enter into contracts for the transfer of nonfinancial assets. 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 the consideration to which the entity expects to be entitled in exchange for those goods or services. Additional disclosures are required to provide quantitative and qualitative information regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new guidance is effective for annual reporting periods, and interim reporting periods within those annual periods, beginning after December 15, 2016. Early adoption is not permitted. Management is currently evaluating the impact of the adoption of this guidance on the Company’s consolidated financial statements.

In January 2014, the FASB issued ASU 2014-04, "Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure." The objective of the amendments in ASU 2014-04 to Topic 310, "Receivables - Troubled Debt Restructurings by Creditors," is to reduce diversity by clarifying when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. An entity can elect to adopt the amendments using either a modified retrospective transition method or a prospective transition method. Early adoption is permitted. The adoption of this guidance is not expected to have a material impact on the Company's Consolidated Financial Statements.

Securities:

The following table summarizes the amortized cost and fair value of the available-for-sale investment securities portfolio at September 30, 2014 and December 31, 2013 and the corresponding amounts of unrealized gains and losses recognized in accumulated other comprehensive income (loss):

(In Thousands of Dollars)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2014				
U.S. Treasury and U.S. government sponsored entities	$ 27,220	$ 482	$ (173)	$ 27,529
State and political subdivisions	91,767	2,194	(1,000)	92,961
Corporate bonds	936	2	(5)	933
Mortgage-backed securities - residential	234,907	1,789	(2,090)	234,606
Collateralized mortgage obligations	27,089	140	(1,298)	25,931
Small business administration	23,931	1	(1,215)	22,717
Equity securities	119	100	(1)	218
Totals	$ 405,969	$ 4,708	$ (5,782)	$ 404,895

(In Thousands of Dollars)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2013				
U.S. Treasury and U.S. government sponsored entities	$ 50,942	$ 755	$ (387)	$ 51,310
State and political subdivisions	96,239	1,302	(2,807)	94,734
Corporate bonds	1,540	0	(15)	1,525
Mortgage-backed securities - residential	226,865	1,199	(5,084)	222,980
Collateralized mortgage obligations	30,227	162	(1,713)	28,676
Small business administration	25,592	1	(2,020)	23,573
Equity securities	117	70	0	187

Totals	$ 431,522	$ 3,489	$ (12,026)	$ 422,985

Proceeds from the sale of portfolio securities were $917 thousand and $34.2 million during the three and nine month periods ended September 30, 2014. Gross gains of $2 thousand and $335 thousand were realized on these sales during the three and nine month periods ended September 30, 2014. Gross losses of $1 thousand and $250 thousand were realized on these sales during the three and nine month periods ended September 30, 2014. Proceeds from the sales of equity securities were $54.7 million and $55.6 million during the three and nine month period ended September 30, 2013. Gross gains of $738 thousand and $994 thousand along with gross losses of $141 thousand were realized on these sales during the three and nine month period ended September 30, 2013.

The amortized cost and fair value of the debt securities portfolio are shown by expected maturity. Expected maturities may differ from contractual maturities if issuers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

(In Thousands of Dollars)	September 30, 2014 Amortized Cost	Fair Value
Maturity		
Within one year	$9,912	$10,027
One to five years	56,358	57,174
Five to ten years	40,745	41,349
Beyond ten years	12,908	12,873
Mortgage-backed, collateralized mortgage obligations and small business administration securities	285,927	283,254
Total	$405,850	$404,677

The following table summarizes the investment securities with unrealized losses at September 30, 2014 and December 31, 2013, aggregated by major security type and length of time in a continuous unrealized loss position. Unrealized losses for U.S. Treasury and U.S. government sponsored entities and corporate bonds, for less than twelve months, rounded to less than $1 thousand in 2014. In addition, unrealized losses for equity securities rounded to less than $1 thousand in 2013.

(In Thousands of Dollars)	Less than 12 Months Fair Value	Unrealized Loss	12 Months or Longer Fair Value	Unrealized Loss	Total Fair Value	Unrealized Loss
September 30, 2014						
Available-for-sale						
U.S. Treasury and U.S. government sponsored entities	$595	$ 0	$10,301	$ (173)	$10,896	$ (173)
State and political subdivisions	772	(2)	24,347	(998)	25,119	(1,000)
Corporate bonds	99	$ 0	479	(5)	578	(5)
Mortgage-backed securities - residential	52,822	(245)	70,198	(1,845)	123,020	(2,090)
Collateralized mortgage obligations	0	0	19,782	(1,298)	19,782	(1,298)
Small business administration	0	0	22,613	(1,215)	22,613	(1,215)
Equity securities	12	(1)	0	0	12	(1)
Total	$54,300	$ (248)	$147,720	$ (5,534)	$202,020	$ (5,782)

(In Thousands of Dollars)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Loss	12 Months or Longer Fair Value	12 Months or Longer Unrealized Loss	Total Fair Value	Total Unrealized Loss
December 31, 2013						
Available-for-sale						
U.S. Treasury and U.S. government sponsored entities	$20,776	$ (387)	$0	$ 0	$20,776	$ (387)
State and political subdivisions	34,851	(1,855)	7,492	(952)	42,343	(2,807)
Corporate bonds	1,052	(2)	473	(13)	1,525	(15)
Mortgage-backed securities - residential	141,024	(3,735)	27,026	(1,349)	168,050	(5,084)
Collateralized mortgage obligations	5,283	(450)	15,726	(1,263)	21,009	(1,713)
Small business administration	6,927	(491)	16,520	(1,529)	23,447	(2,020)
Equity securities	7	0	0	0	7	0
Total	$209,920	$ (6,920)	$67,237	$ (5,106)	$277,157	$ (12,026)

Other-Than-Temporary-Impairment

Management evaluates securities for other-than-temporary impairment ("OTTI") at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Investment securities are generally evaluated for OTTI under FASB Accounting Standards Codification ("ASC") 320, Investments – Debt and Equity Securities. Consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, whether the market decline was affected by macroeconomic conditions and whether the Company has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. In analyzing an issuer's financial condition, the Company may consider whether the securities are issued by the federal government or its agencies, or U.S. government sponsored enterprises, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When OTTI occurs, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis. If an entity intends to sell or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, the OTTI shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income or loss. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

As of September 30, 2014, the Company's security portfolio consisted of 378 securities, 91 of which were in an unrealized loss position. The majority of the unrealized losses on the Company's securities are related to its holdings of mortgage-backed securities, collateralized mortgage obligations, state and political subdivision securities, and small business administration securities as discussed below.

Unrealized losses on debt securities issued by state and political subdivisions have not been recognized into income. Generally these securities have maintained their investment grade ratings and management does not have the intent and is not required to sell these securities before their anticipated recovery. The fair value is expected to recover as the securities approach their maturity date.

All of the Company's holdings of collateralized mortgage obligations and residential mortgage-backed securities were issued by U.S. government-sponsored entities. Unrealized losses on these securities have not been recognized into income. Because the decline in fair value is attributable to changes in interest rates and illiquidity, and not credit quality, the issues are guaranteed by the issuing entity and which the U.S. government has affirmed its commitment to support, and because the Company does not have the intent to sell these residential mortgage-backed securities and it is likely that it will not be required to sell the securities before their anticipated recovery, the Company does not consider these securities to be OTTI.

Management does not believe any unrealized losses on small business administration securities represent an other-than-temporary impairment. The securities are issued and backed by the full faith and credit of the U.S. government and the Company does not have the intent to sell these securities before their anticipated recovery. The fair value of these securities is expected to recover as they approach their maturity.

Loans:

Loan balances were as follows:

(In Thousands of Dollars)	September 30, 2014	December 31, 2013
Commercial real estate		
Owner occupied	$ 75,881	$ 86,286
Non-owner occupied	116,082	107,625
Other	23,151	24,381
Commercial	115,418	105,023
Residential real estate		
1-4 family residential	149,576	144,225
Home equity lines of credit	29,818	26,448
Consumer		
Indirect	121,819	121,446
Direct	9,723	10,237
Other	3,323	3,031
Subtotal	$ 644,791	$ 628,702
Net deferred loan costs	2,190	1,982
Allowance for loan losses	(7,333)	(7,568)
Net loans	$ 639,648	$ 623,116

The following tables present the activity in the allowance for loan losses by portfolio segment for the three and nine month periods ended September 30, 2014 and 2013:

Three Months Ended September 30, 2014

(In Thousands of Dollars)	Commercial Real Estate	Commercial	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses						
Beginning balance	$ 2,722	$ 1,076	$ 1,784	$ 1,518	$ 256	$ 7,356
Provision for loan losses	(449)	322	301	353	(102)	425
Loans charged off	0	(6)	(245)	(505)	0	(756)
Recoveries	30	14	23	241	0	308
Total ending allowance balance	$ 2,303	$ 1,406	$ 1,863	$ 1,607	$ 154	$ 7,333

Nine Months Ended September 30, 2014

(In Thousands of Dollars)	Commercial	Commercial	Residential	Consumer	Unallocated	Total

	Real Estate		Real Estate			
Allowance for loan losses						
Beginning balance	$ 2,752	$ 1,219	$ 1,964	$ 1,419	$ 214	$7,568
Provision for loan losses	(463)	185	378	1,015	(60)	1,055
Loans charged off	(90)	(25)	(525)	(1,602)	0	(2,242)
Recoveries	104	27	46	775	0	952
Total ending allowance balance	$ 2,303	$ 1,406	$ 1,863	$ 1,607	$ 154	$7,333

Three Months Ended September 30, 2013

(In Thousands of Dollars)	Commercial Real Estate	Commercial	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses						
Beginning balance	$ 3,050	$ 1,431	$ 1,751	$ 1,180	$ 178	$7,590
Provision for loan losses	(213)	(14)	171	398	(2)	340
Loans charged off	(219)	0	(135)	(561)	0	(915)
Recoveries	33	38	26	257	0	354
Total ending allowance balance	$ 2,651	$ 1,455	$ 1,813	$ 1,274	$ 176	$7,369

Nine Months Ended September 30, 2013

(In Thousands of Dollars)	Commercial Real Estate	Commercial	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses						
Beginning balance	$ 3,392	$ 1,453	$ 1,569	$ 951	$ 264	$7,629
Provision for loan losses	(606)	(87)	508	1,038	(88)	765
Loans charged off	(300)	(80)	(303)	(1,351)	0	(2,034)
Recoveries	165	169	39	636	0	1,009
Total ending allowance balance	$ 2,651	$ 1,455	$ 1,813	$ 1,274	$ 176	$7,369

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of September 30, 2014 and December 31, 2013. The recorded investment in loans includes the unpaid principal balance and unamortized loan origination fees and costs, but excludes accrued interest receivable, which is not considered to be material:

September 30, 2014

(In Thousands of Dollars)	Commercial Real Estate	Commercial	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 157	$ 352	$ 90	$ 0	$ 0	$599
Collectively evaluated for impairment	2,146	1,054	1,773	1,607	154	6,734

Total ending allowance balance	$ 2,303	$ 1,406	$ 1,863	$ 1,607	$ 154	$ 7,333
Loans:						
Loans individually evaluated for impairment	$ 5,975	$ 1,795	$ 3,505	$ 133	$ 0	$ 11,408
Loans collectively evaluated for impairment	208,497	113,307	175,426	138,343	0	635,573
Total ending loans balance	$ 214,472	$ 115,102	$ 178,931	$ 138,476	$ 0	$ 646,981

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December 31, 2013

(In Thousands of Dollars)	Commercial Real Estate	Commercial	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 166	$ 110	$ 202	$ 82	$ 0	$ 560
Collectively evaluated for impairment	2,586	1,109	1,762	1,337	214	7,008
Total ending allowance balance	$ 2,752	$ 1,219	$ 1,964	$ 1,419	$ 214	$ 7,568
Loans:						
Loans individually evaluated for impairment	$ 6,623	$ 2,430	$ 2,554	$ 363	$ 0	$ 11,970
Loans collectively evaluated for impairment	210,739	102,593	167,597	137,785	0	618,714
Total ending loans balance	$ 217,362	$ 105,023	$ 170,151	$ 138,148	$ 0	$ 630,684

The following tables present information related to impaired loans by class of loans as of September 30, 2014 and December 31, 2013:

(In Thousands of Dollars)	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
September 30, 2014			
With no related allowance recorded:			
Commercial real estate			
Owner occupied	$ 2,509	$ 2,374	$ 0
Non-owner occupied	398	397	0
Commercial	773	736	0
Residential real estate			
1-4 family residential	2,518	2,244	0
Home equity lines of credit	467	236	0
Consumer	247	133	0
Subtotal	6,912	6,120	0
With an allowance recorded:			
Commercial real estate			
Owner occupied	1,645	1,643	84

Non-owner occupied	1,562	1,561	73
Commercial	1,062	1,059	352
Residential real estate			
1-4 family residential	953	934	87
Home equity lines of credit	91	91	3
Subtotal	5,313	5,288	599
Total	$ 12,225	$ 11,408	$ 599

(In Thousands of Dollars)	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
December 31, 2013			
With no related allowance recorded:			
Commercial real estate			
Owner occupied	$ 4,302	$ 3,762	$ 0
Non-owner occupied	491	389	0
Commercial	1,007	971	0
Residential real estate			
1-4 family residential	1,026	961	0
Home equity lines of credit	107	99	0
Consumer	111	112	0
Subtotal	7,044	6,294	0
With an allowance recorded:			
Commercial real estate			
Owner occupied	886	884	91
Non-owner occupied	1,593	1,588	75
Commercial	1,462	1,459	110
Residential real estate			
1-4 family residential	1,458	1,347	190
Home equity lines of credit	148	147	12
Consumer	247	251	82
Subtotal	5,794	5,676	560
Total	$ 12,838	$ 11,970	$ 560

The following table presents the average recorded investment in impaired loans by class and interest income recognized by loan class for the three and nine month periods ended September 30, 2014 and 2013:

	Average Recorded Investment For Three Months Ended September 30,		Interest Income Recognized For Three Months Ended September 30,
(In Thousands of Dollars)	2014	2013	2014
With no related allowance recorded:			
Commercial real estate			
Owner occupied	$ 1,939	$ 2,557	$ 9
Non-owner occupied	399	421	6
Commercial	1,496	1,597	4

Residential real estate			
1-4 family residential	2,077	2,125	16
Home equity lines of credit	363	215	2
Consumer	138	0	0
Subtotal	6,412	6,915	37
With an allowance recorded:			
Commercial real estate			
Owner occupied	2,068	2,498	25
Non-owner occupied	1,563	1,612	20
Commercial	413	253	1
Residential real estate			
1-4 family residential	1,062	0	10
Home equity lines of credit	91	0	1
Consumer	7	0	0
Subtotal	5,204	4,363	57
Total	$11,616	$11,278	$ 94

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(In Thousands of Dollars)	Average Recorded Investment For Nine Months Ended September 30, 2014	2013	Interest Income Recognized For Nine Months Ended September 30, 2014
With no related allowance recorded:			
Commercial real estate			
Owner occupied	$2,042	$2,533	$ 20
Non-owner occupied	399	454	14
Commercial	1,500	1,485	13
Residential real estate			
1-4 family residential	1,689	1,349	44
Home equity lines of credit	269	192	6
Consumer	185	0	0
Subtotal	6,084	6,013	97
With an allowance recorded:			
Commercial real estate			
Owner occupied	1,982	2,714	76
Non-owner occupied	1,576	1,816	61
Commercial	632	295	3
Residential real estate			
1-4 family residential	1,277	0	31
Home equity lines of credit	121	0	3
Consumer	5	0	0
Subtotal	5,593	4,825	174
Total	$11,677	$10,838	$ 271

Cash basis interest recognized during the three and nine month periods ended September 30, 2014 was materially equal to interest income recognized. Interest income recognized and cash basis interest recognized during impairment for the three and nine month periods ended September 30, 2013 was immaterial.

Nonaccrual loans and loans past due 90 days or more still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following table presents the recorded investment in nonaccrual and loans past due 90 days or more still on accrual by class of loans as of September 30, 2014 and December 31, 2013:

(In Thousands of Dollars)	September 30, 2014		December 31, 2013	
	Nonaccrual	Loans Past Due	Nonaccrual	Loans Past Due

		90 Days or More Still Accruing		90 Days or More Still Accruing
Commercial real estate				
Owner occupied	$2,181	$ 0	$2,806	$ 0
Non-owner occupied	44	0	405	0
Commercial	1,454	0	1,993	13
Residential real estate				
1-4 family residential	2,974	113	2,584	526
Home equity lines of credit	146	0	280	0
Consumer				
Indirect	114	148	308	94
Direct	40	2	55	3
Other	0	2	0	10
Total	$6,953	$ 265	$8,431	$ 646

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The following table presents the aging of the recorded investment in past due loans as of September 30, 2014 and December 31, 2013 by class of loans:

(In Thousands of Dollars)	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due and Nonaccrual	Total Past Due	Loans Not Past Due	Total
September 30, 2014						
Commercial real estate						
Owner occupied	$44	$0	$ 2,181	$2,225	$73,451	$75,676
Non-owner occupied	0	0	44	44	115,729	115,773
Other	0	0	0	0	23,023	23,023
Commercial	0	0	1,454	1,454	113,648	115,102
Residential real estate						
1-4 family residential	1,637	321	3,087	5,045	144,068	149,113
Home equity lines of credit	67	20	146	233	29,585	29,818
Consumer						
Indirect	2,165	530	262	2,957	122,473	125,430
Direct	135	7	42	184	9,539	9,723
Other	8	4	2	14	3,309	3,323
Total	$4,056	$882	$ 7,218	$12,156	$634,825	$646,981

(In Thousands of Dollars)	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due and Nonaccrual	Total Past Due	Loans Not Past Due	Total
December 31, 2013						
Commercial real estate						
Owner occupied	$48	$0	$ 2,806	$2,854	$83,065	$85,919
Non-owner occupied	0	0	405	405	106,762	107,167
Other	0	0	0	0	24,276	24,276
Commercial	14	0	2,006	2,020	103,003	105,023
Residential real estate						
1-4 family residential	573	141	3,110	3,824	139,879	143,703
Home equity lines of credit	35	0	280	315	26,133	26,448
Consumer						
Indirect	2,004	539	402	2,945	121,935	124,880
Direct	204	31	58	293	9,944	10,237
Other	63	6	10	79	2,952	3,031
Total	$2,941	$717	$ 9,077	$12,735	$617,949	$630,684

Troubled Debt Restructurings:

Total troubled debt restructurings were $8.4 million and $8.3 million at September 30, 2014 and December 31, 2013, respectively. The Company has allocated $253 thousand and $397 thousand of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of September 30, 2014 and December 31, 2013. There were $26 thousand and $16 thousand in commitments to lend additional amounts to borrowers with loans that were classified as troubled debt restructurings at September 30, 2014 and December 31, 2013.

During the three and nine month periods ended September 30, 2014 and 2013, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; a permanent reduction of the recorded investment in the loan; a permanent increase of the recorded investment in the loan due to an advance of new monies; a deferral of principal payments; or a legal concession.

Troubled debt restructuring modifications involved a reduction of the notes stated interest rate in the range of 0.4% and 2.8%. There were also extensions of the maturity dates on these and other troubled debt restructurings in the range of 27 months to 71 months.

The following table presents loans by class modified as troubled debt restructurings that occurred during the three and nine month periods ended September 30, 2014 and 2013:

Three Months Ended September 30, 2014 (In Thousands of Dollars)	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Commercial real estate			
Owner occupied	1	$ 303	$ 316
Residential real estate			
1-4 family residential	5	235	235
Home equity lines of credit	1	17	17
Indirect	2	37	37
Consumer	1	11	11
Total	10	$ 603	$ 616

Nine Months Ended September 30, 2014 (In Thousands of Dollars)	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Commercial real estate			
Owner occupied	1	$ 303	$ 316
Non-owner occupied	2	408	408
Residential real estate			
1-4 family residential	19	1,017	1,034
Home equity lines of credit	4	105	105
Indirect	2	37	37
Consumer	1	11	11
Total	29	$ 1,881	$ 1,911

Three Months Ended September 30, 2013 (In Thousands of Dollars)	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Residential real estate			
1-4 family residential	1	$ 10	$ 10
Home equity lines of credit	1	56	56
Total	2	$ 66	$ 66

Nine Months Ended September 30, 2013 (In Thousands of Dollars)	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Commercial real estate			
Owner occupied	2	$ 226	$ 239
Commercial	5	649	682
Residential real estate			
1-4 family residential	2	18	18
Home equity lines of credit	5	214	214
Total	14	$ 1,107	$ 1,153

There were $10 thousand in charge offs with no increase to the provision for loan losses during the three month period ended September 30, 2014, as a result of troubled debt restructurings. There were $42 thousand in charge offs resulting in an $11 thousand increase to the provision for loan losses during the nine month period ended September 30, 2014. There was $1 thousand in charge offs and no increase to the provision for loan losses during the three month period ended September 30, 2013, as a result of troubled debt restructurings. During the nine month period ended September 30, 2013, there were $17 thousand in charge offs and no increase to the provision for loan losses due to the troubled debt restructurings described above.

There was one residential real estate loan for which there were payment defaults within twelve months following the modification of the troubled debt restructuring during the three and nine month periods ended September 30, 2014. This loan was past due at September 30, 2014. There was no effect on the provision for loan losses as a result of this default during 2014. A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

There were two commercial loans and one commercial real estate loan modified as troubled debt restructuring for which there were payments defaults within twelve months following the modification during the three and nine months periods ended September 30, 2013. Two of the three loans were past due at September 30, 2013. There was no additional provision or any impact to the allowance for loan losses associated with these loans.

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company establishes a risk rating at origination for all commercial loan and commercial real estate relationships. For relationships over $750 thousand, management monitors the loans on an ongoing basis for any changes in the borrower's ability to service their debt. Management also affirms the risk ratings for the loans and leases in their respective portfolios on an annual basis. The Company uses the following definitions for risk ratings:

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Substandard loans are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans.

As of September 30, 2014 and December 31, 2013, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

(In Thousands of Dollars)	Pass	Special Mention	Sub-standard	Doubtful	Not Rated	Total
September 30, 2014						
Commercial real estate						
Owner occupied	$68,749	$ 1,993	$4,934	$ 0	$ 0	$75,676
Non-owner occupied	109,237	3,796	2,740	0	0	115,773
Other	22,698	0	325	0	0	23,023
Commercial	110,340	1,563	3,199	0	0	115,102
Total	$311,024	$ 7,352	$11,198	$ 0	$ 0	$329,574

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(In Thousands of Dollars)	Pass	Special Mention	Sub-standard	Doubtful	Not Rated	Total
December 31, 2013						
Commercial real estate						
Owner occupied	$72,398	$7,312	$6,209	$ 0	$ 0	$85,919
Non-owner occupied	96,065	7,877	3,225	0	0	107,167
Other	23,935	0	341	0	0	24,276
Commercial	99,022	2,313	3,688	0	0	105,023
Total	$291,420	$17,502	$13,463	$ 0	$ 0	$322,385

The Company considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential, consumer indirect and direct loan classes, the Company also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity.

The following table presents the recorded investment in residential, consumer indirect and direct auto loans based on payment activity as of September 30, 2014 and December 31, 2013. Nonperforming loans are loans past due 90 days or more and still accruing interest and nonaccrual loans.

	Residential Real Estate		Consumer		
(In Thousands of Dollars)	1-4 Family Residential	Home Equity Lines of Credit	Indirect	Direct	Other
September 30, 2014					
Performing	$146,026	$29,672	$125,168	$9,681	$3,321
Nonperforming	3,087	146	262	42	2
Total	$149,113	$29,818	$125,430	$9,723	$3,323

	Residential Real Estate		Consumer		
(In Thousands of Dollars)	1-4 Family Residential	Home Equity Lines of Credit	Indirect	Direct	Other
December 31, 2013					
Performing	$140,593	$26,168	$124,478	$10,179	$3,021
Nonperforming	3,110	280	402	58	10
Total	$143,703	$26,448	$124,880	$10,237	$3,031

Interest-Rate Swaps:

The Company uses a program that utilizes interest-rate swaps as part of its asset/liability management strategy. The interest-rate swaps are used to help manage the Company's interest rate risk position and not as derivatives for trading purposes. The notional amount of the interest-rate swaps does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest-rate swap agreements.

The objective of the interest-rate swaps is to protect the related fixed rate commercial real estate loans from changes in fair value due to changes in interest rates. The Company has a program whereby it lends to its borrowers at a fixed rate with the loan agreement containing a two-way yield maintenance provision, which will be invoked in the event of prepayment of the loan, and is expected to exactly offset the fair value of unwinding the swap. The yield maintenance provision represents an embedded derivative which is bifurcated from the host loan contract and, as such, the swaps and embedded derivatives are not designated as hedges. Accordingly, both instruments are carried at fair value and changes in fair value are reported in current period earnings.

Summary information about these interest-rate swaps at periods ended September 30, 2014 and December 31, 2013 is as follows:

	September 30, 2014		December 31, 2013	
Notional amounts	$ 24,729		$ 25,195	
Weighted average pay rate on interest-rate swaps	4.06	%	4.28	%
Weighted average receive rate on interest-rate swaps	2.67	%	2.82	%
Weighted average maturity (years)	5.2		6.3	
Fair value of combined interest-rate swaps	$ 356		$ 275	

The fair value of the yield maintenance provisions and interest-rate swaps is recorded in other assets and other liabilities, respectively, in the consolidated balance sheets. Changes in the fair value of the yield maintenance provisions and interest-rate swaps are reported in earnings, as other noninterest income in the consolidated statements of income. For the three and nine month periods ended September 30, 2014 and 2013 there were no net gains or losses recognized in earnings.

Earnings Per Share:

The computation of basic and diluted earnings per share is shown in the following table:

	Three Months Ended Sept 30,		Nine Months Ended Sept 30,	
	2014	2013	2014	2013
Basic EPS				
Net income	$2,276	$1,612	$6,818	$5,485
Weighted average shares outstanding	18,716,094	18,775,980	18,761,352	18,772,664
Basic earnings per share	$0.12	$0.09	$0.36	$0.29
Diluted EPS				
Net income	$2,276	$1,612	$6,818	$5,485
Weighted average shares out-standing for basic earnings per share	18,716,094	18,775,980	18,761,352	18,772,664
Restricted stock awards	974	0	367	0
Weighted average shares for diluted earnings per share	18,717,068	18,775,980	18,761,719	18,772,664
Diluted earnings per share	$0.12	$0.09	$0.36	$0.29

There were no outstanding stock options for the three and nine month periods ended September 30, 2014. Stock options for 5,000 shares of common stock that were outstanding during the three and nine month periods ended September 30, 2013 were not considered in computing diluted earnings per share because they were antidilutive.

Stock Based Compensation:

During 2012, the Company, with the approval of shareholders, created the 2012 Equity Incentive Plan (the “Plan”). The Plan permits the award of up to 500 thousand shares to the Company’s directors and employees to promote the Company’s long-term financial success by motivating performance through long-term incentive compensation and to better align the interests of its employees with those of its shareholders. 46,957 share awards were granted under the Plan during February 2014. Expense recognized for the Plan was $29 thousand and $87 thousand for the three and nine month periods ended September 30, 2014. As of September 30, 2014, there was $260 thousand of total unrecognized compensation expense related to the nonvested shares granted under the Plan. The remaining cost is expected to be recognized over 2.25 years. There were no shares awarded or expense recognized during the three and nine month periods ended September 30, 2013.

The following is the activity under the Plan during the nine months ended September 30, 2014:

	Restricted Stock Units	
September 30, 2014	Units	Weighted Average Grant Date Fair Value
Beginning balance	0	$ 0
Granted	46,957	7.39
Vested	0	0
Forfeited	0	0
Ending balance	46,957	$ 7.39

The Company's Stock Option Plan, which was shareholder-approved and has since expired, permitted the grant of share options to its directors, officers and employees for up to 375 thousand shares of common stock. Option awards were granted with an exercise price equal to the market price of the Company's common stock at the date of grant; those option awards had vesting periods of 5 years and had 10-year contractual terms. During the first quarter of 2014 the last remaining 5,000 outstanding options were exercised and the Company satisfied these options with the reissuance of treasury shares.

The fair value of each option award is estimated on the date of grant using a Black-Scholes model. Total compensation cost charged against income for the stock option plan for the three and nine month periods ended September 30, 2014 and 2013 was not material. No related income tax benefit was recorded.

Other Comprehensive Income (Loss):

The following table represents the detail of other comprehensive income (loss) for three and nine month periods ended September 30, 2014 and 2013.

	Three Months Ended September 30, 2014		
(In Thousands of Dollars)	Pre-tax	Tax	After-Tax
Unrealized holding gains on available-for-sale securities during the period	$527	$(184)	$ 343
Reclassification adjustment for (gains) losses included in net income (1)	(1)	0	(1)
Net unrealized gains on available-for-sale securities	$526	$(184)	$ 342

	Nine Months Ended September 30, 2014		
(In Thousands of Dollars)	Pre-tax	Tax	After-Tax
Unrealized holding gains on available-for-sale securities during the period	$7,547	$(2,642)	$ 4,905
Reclassification adjustment for (gains) losses included in net income (1)	(85)	30	(55)
Net unrealized gains on available-for-sale securities	$7,462	$(2,612)	$ 4,850

	Three Months Ended September 30, 2013		
(In Thousands of Dollars)	Pre-tax	Tax	After-Tax
Unrealized holding losses on available-for-sale securities during the period	$(5,939)	$2,077	$ (3,862)
Reclassification adjustment for (gains) losses included in net income (1)	(597)	209	(388)
Net unrealized losses on available-for-sale securities	$(6,536)	$2,286	$ (4,250)

	Nine Months Ended September 30, 2013		
(In Thousands of Dollars)	Pre-tax	Tax	After-Tax
Unrealized holding losses on available-for-sale securities during the period	$(17,399)	$6,090	$(11,309)
Reclassification adjustment for (gains) losses included in net income (1)	(853)	298	(555)
Net unrealized losses on available-for-sale securities	$(18,252)	$6,388	$(11,864)

(1) Pre-tax reclassification adjustments relating to available-for-sale securities are reported in security gains and the tax impact is included in income tax expense on the consolidated statements of income.

Fair Value:

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 – Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Investment Securities: The Company uses a third party service to estimate fair value on available for sale securities on a monthly basis. This service provider is considered a leading evaluation pricing service for U.S. domestic fixed income securities. They subscribe to multiple third-party pricing vendors, and supplement that information with matrix pricing methods. The fair values for investment securities are determined by quoted market prices in active markets, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on quoted prices for similar assets in active markets, quoted prices for similar assets in markets that are not active or inputs other than quoted prices, which provide a reasonable basis for fair value determination. Such inputs may include interest rates and yield curves, volatilities, prepayment speeds, credit risks and default rates. Inputs used are derived principally from observable market data (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). The fair values of Level 3 investment securities are determined by using unobservable inputs to measure fair value of assets for which there is little, if any market activity at the measurement date, using reasonable inputs and assumptions based on the best information at the time, to the extent that inputs are available without undue cost and effort. For the period ended September 30, 2014 and for the year ended December 31, 2013, the fair value of Level 3 investment securities was immaterial.

Derivative Instruments: The fair values of derivative instruments are based on valuation models using observable market data as of the measurement date (Level 2).

Impaired Loans: At the time loans are considered impaired, collateral dependent impaired loans are valued at the lower of cost or fair value and non-collateral dependent loans are valued based on discounted cash flows. Impaired loans carried at fair value generally receive specific allocations of the allowance for loan losses. For collateral dependent loans fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Other Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair values are commonly based on recent real estate appraisals. These appraisals may use a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Appraisals for both collateral-dependent impaired loans and other real estate owned are performed by certified general appraisers (for commercial and commercial real estate properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, a member of the Appraisal Department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On an annual basis, the Company compares the actual selling price of collateral that has been sold to the most recent appraised value to determine what adjustments should be made to appraisals to arrive at fair value.

Assets measured at fair value on a recurring basis, including financial assets for which the Company has elected the fair value option, are summarized below:

	Fair Value Measurements at September 30, 2014 Using:			
(In Thousands of Dollars)	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
Investment securities available-for sale				
U.S. Treasury and U.S. government sponsored entities	$27,529	$ 0	$ 27,529	$ 0
State and political subdivisions	92,961	0	92,961	0
Corporate bonds	933	0	933	0
Mortgage-backed securities-residential	234,606	0	234,596	10
Collateralized mortgage obligations	25,931	0	25,931	0
Small business administration	22,717	0	22,717	0
Equity securities	218	218	0	0
Total investment securities	$404,895	$ 218	$ 404,667	$ 10
Yield maintenance provisions	$356	$ 0	$ 356	$ 0
Financial Liabilities				
Interest rate swaps	$356	$ 0	$ 356	$ 0

	Fair Value Measurements at December 31, 2013 Using:			
(In Thousands of Dollars)	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
Investment securities available-for sale				
U.S. Treasury and U.S. government sponsored entities	$51,310	$ 0	$ 51,310	$ 0
State and political subdivisions	94,734	0	94,734	0
Corporate bonds	1,525	0	1,525	0
Mortgage-backed securities-residential	222,980	0	222,970	10
Collateralized mortgage obligations	28,676	0	28,676	0
Small business administration	23,573	0	23,573	0
Equity securities	187	187	0	0
Total investment securities	$422,985	$ 187	$ 422,788	$ 10
Yield maintenance provisions	$275	$ 0	$ 275	$ 0

Financial Liabilities				
Interest rate swaps	$ 275	$ 0	$ 275	$ 0

There were no significant transfers between Level 1 and Level 2 during the three and nine month periods ended September 30, 2014 and 2013.

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The table below presents a reconciliation for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

(In Thousands of Dollars)	Investment Securities Available-for-sale (Level 3) Three Months ended September 30, 2014	2013	Nine Months ended September 30, 2014	2013
Beginning Balance	$10	$11	$10	$11
Total unrealized gains or losses:				
Included in other comprehensive income	0	0	0	0
Repayments	0	0	0	0
Transfers in and/or out of Level 3	0	0	0	0
Ending Balance	$10	$11	$10	$11

Assets measured at fair value on a non-recurring basis are summarized below:

(In Thousands of Dollars)	Fair Value Measurements at September 30, 2014 Using: Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
Impaired loans				
Commercial	$628	$ 0	$ 0	$ 628
1–4 family residential	138	0	0	138
Other real estate owned				
1–4 family residential	33	0	0	33
Commercial real estate	70	0	0	70

(In Thousands of Dollars)	Fair Value Measurements at December 31, 2013 Using: Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

Financial Assets				
Impaired loans				
Commercial real estate				
Owner occupied	$962	$ 0	$ 0	$ 962
Non-owner occupied	391	0	0	391
Commercial	1,575	0	0	1,575
1–4 family residential	577	0	0	577
Home equity lines of credit	174	0	0	174
Consumer indirect	142	0	0	142
Consumer direct	22	0	0	22
Other real estate owned				
1–4 family residential	33	0	0	33

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of $1.1 million with a valuation allowance of $357 thousand at September 30, 2014, resulting in an additional provision for loan losses of $338 thousand and $554 thousand for the three and nine month period. At December 31, 2013, impaired loans had a principal balance of $4.2 million, with a valuation allowance of $363 thousand. Loans measured at fair value during the three and nine months ended September 30, 2013 resulted in an additional provision for loan losses of $431 thousand and $714 thousand. Excluded from the fair value of impaired loans, at September 30, 2014 and December 31, 2013, discussed above are $4.2 million and $3.0 million of loans classified as troubled debt restructurings and measured using the present value of cash flows, which are not carried at fair value.

Impaired commercial real estate loans, both owner occupied and non-owner occupied are valued by independent external appraisals. These external appraisals are prepared using the sales comparison approach and income approach valuation techniques. Management makes subsequent unobservable adjustments to the impaired loan appraisals. Impaired loans other than commercial real estate and other real estate owned are not considered material.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at period ended September 30, 2014 and December 31, 2013:

September 30, 2014	Fair value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Impaired loans				
Commercial	$ 628	Sales comparison	Adjustment for differences between comparable sales	-21.21% - 21.21% (6.70%)
Residential	138	Sales comparison	Adjustment for differences between comparable sales	-23.61% - 24.16% (-2.37%)
Other real estate owned	103	Sales comparison	Adjustment for differences between comparable sales	-24.98% - 17.00% (5.01%)

December 31, 2013	Fair value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Impaired loans				
Commercial real estate	$ 1,237	Sales comparison	Adjustment for differences between comparable sales	-41.59% - 77.25% (-7.82%)
	116	Income approach	Adjustment for differences in net operating income	-13.64% - 12.93% (-5.96%)
Commercial	1,575	Sales comparison	Adjustment for differences between comparable sales	-25.56% - 33.03% (17.42%)
Residential	751	Sales comparison	Adjustment for differences between comparable sales	-46.81% - 23.45% (-7.00%)
Consumer	164	Sales comparison	Adjustment for differences between comparable sales	-29.00% - 29.00% (0.00%)

The carrying amounts and estimated fair values of financial instruments not previously disclosed at September 30, 2014 and December 31, 2013 are as follows:

		Fair Value Measurements at September 30, 2014 Using:			
(In Thousands of Dollars)	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	$28,294	$14,719	$13,575	$0	$28,294
Restricted stock	4,224	n/a	n/a	n/a	n/a
Loans held for sale	895	0	916	0	916
Loans, net	639,648	0	0	642,950	642,950
Accrued interest receivable	3,639	0	1,973	1,666	3,639
Financial liabilities					
Deposits	913,000	702,032	211,072	0	913,104
Short-term borrowings	72,032	0	72,032	0	72,032
Long-term borrowings	18,617	0	19,142	0	19,142
Accrued interest payable	416	2	414	0	416

(In Thousands of Dollars)	Carrying Amount	Fair Value Measurements at December 31, 2013 Using: Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	$27,513	$12,957	$14,556	$0	$27,513
Restricted stock	4,224	n/a	n/a	n/a	n/a
Loans held for sale	158	0	161	0	161
Loans, net	623,116	0	0	623,875	623,875
Accrued interest receivable	3,399	0	1,844	1,555	3,399
Financial liabilities					
Deposits	915,216	688,470	228,116	0	916,586
Short-term borrowings	81,617	0	81,617	0	81,617
Long-term borrowings	19,822	0	20,526	0	20,526
Accrued interest payable	447	2	445	0	447

The methods and assumptions used to estimate fair value, not previously described, are described as follows:

Cash and Cash Equivalents: The carrying amounts of cash and short-term instruments approximate fair values and are classified as either Level 1 or Level 2. The Company has determined that cash on hand and non-interest bearing due from bank accounts are Level 1 whereas interest bearing federal funds sold and other are Level 2.

Restricted Stock: It is not practical to determine the fair value of restricted stock due to restrictions placed on its transferability.

Loans: Fair values of loans, excluding loans held for sale, are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described previously. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

Loans held for sale: The fair value of loans held for sale is estimated based upon binding contracts and quotes from third party investors resulting in a Level 2 classification.

Accrued Interest Receivable/Payable: The carrying amounts of accrued interest receivable and payable approximate fair value resulting in a Level 1, Level 2 or Level 3 classification. The classification is the result of the association with securities, loans and deposits.

Deposits: The fair values disclosed for demand deposits – interest and non-interest checking, passbook savings, and money market accounts – are, by definition, equal to the amount payable on demand at the reporting date resulting in a Level 1 classification. The carrying amounts of variable rate certificates of deposit approximate their fair values at the reporting date resulting in a Level 2 classification. Fair value for fixed rate certificates of deposit are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

Short-term Borrowings: The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings, generally maturing within ninety days, approximate their fair values resulting in a Level 2 classification.

Long-term Borrowings: The fair values of the Company's long-term borrowings are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

Off-balance Sheet Instruments: The fair value of commitments is not considered material.

Segment Information:

The reportable segments are determined by the products and services offered, primarily distinguished between banking, trust and retirement consulting operations. They are also distinguished by the level of information provided to the chief operating decision makers in the Company, who use such information to review performance of various components of the business, which are then aggregated. Loans, investments, and deposits provide the revenues in the banking operation. All operations are domestic.

Significant segment totals are reconciled to the financial statements as follows:

(In Thousands of Dollars)	Trust Segment	Bank Segment	Retirement Consulting Segment	Eliminations and Others	Consolidated Totals
September 30, 2014					
Goodwill and other intangibles	$5,374	$0	$ 4,394	$ 0	$9,768
Total assets	$10,937	$1,133,211	$ 5,181	$ (9,590)	$1,139,739

(In Thousands of Dollars)	Trust Segment	Bank Segment	Retirement Consulting Segment	Eliminations and Others	Consolidated Totals
December 31, 2013					
Goodwill and other intangibles	$5,639	$0	$ 4,704	$ 0	$10,343
Total assets	$11,572	$1,120,091	$ 5,090	$ 573	$1,137,326

(In Thousands of Dollars)	Trust Segment	Bank Segment	Retirement Consulting Segment	Eliminations and Others	Consolidated Totals
For Three Months Ended September 30, 2014					
Net interest income	$ 13	$9,276	$ 0	$ (4)	$ 9,285
Provision for loan losses	0	425	0	0	425
Service fees, security gains and other noninterest income	1,575	1,971	395	(61)	3,880
Noninterest expense	1,234	7,794	421	327	9,776
Income (loss) before taxes	354	3,028	(26)	(392)	2,964
Income taxes	121	708	(9)	(132)	688
Net Income (Loss)	$ 233	$2,320	$ (17)	$ (260)	$ 2,276

(In Thousands of Dollars)	Trust Segment	Bank Segment	Retirement Consulting Segment	Eliminations and Others	Consolidated Totals
For Nine Months Ended September 30, 2014					
Net interest income	$ 39	$27,065	$ 0	$ (11)	$ 27,093
Provision for loan losses	0	1,055	0	0	1,055
Service fees, security gains and other noninterest income	4,666	5,265	1,392	(213)	11,110
Noninterest expense	3,614	22,528	1,245	908	28,295

Income before taxes	1,091	8,747	147	(1,132)	8,853
Income taxes	374	1,987	50	(376)	2,035
Net Income	$ 717	$ 6,760	$ 97	$ (756)	$ 6,818

(In Thousands of Dollars)	Trust Segment	Bank Segment	Retirement Consulting Segment	Eliminations and Others	Consolidated Totals
For Three Months Ended September 30, 2013					
Net interest income	$ 11	$ 8,840	$ 0	$ (3)	$ 8,848
Provision for loan losses	0	340	0	0	340
Service fees, security gains and other noninterest income	1,389	2,489	280	15	4,173
Noninterest expense	1,213	8,774	428	511	10,926
Income before taxes	187	2,215	(148)	(499)	1,755
Income taxes	65	298	(50)	(170)	143
Net Income	$ 122	$ 1,917	$ (98)	$ (329)	$ 1,612

(In Thousands of Dollars)	Trust Segment	Bank Segment	Retirement Consulting Segment	Eliminations and Others	Consolidated Totals
For Nine Months Ended September 30, 2013					
Net interest income	$ 34	$ 26,831	$ 0	$ (10)	$ 26,855
Provision for loan losses	0	765	0	0	765
Service fees, security gains and other noninterest income	4,167	5,781	280	45	10,273
Noninterest expense	3,711	24,406	428	1,291	29,836
Income before taxes	490	7,441	(148)	(1,256)	6,527
Income taxes	170	1,349	(50)	(427)	1,042
Net Income	$ 320	$ 6,092	$ (98)	$ (829)	$ 5,485

The Bank segment includes Farmers National Insurance and Farmers of Canfield Investment Co.

Business Combination:

On July 1, 2013, the Company completed the acquisition of all outstanding stock of the retirement planning consultancy National Associates, Inc. of Cleveland, Ohio. The transaction involved both cash and stock totaling $4.4 million, including up to $1.5 million of future payments, contingent upon NAI meeting income performance targets, with an estimated fair value at the acquisition date of $920,000. The fair market value of the contingent consideration was determined using the Monte Carlo Simulation. The simulation's key assumptions included a two year period with an estimated volatility of 20%. Expected EBITDA had a base of 6% with a maximum 12% and a discount rate of 11.9%. The acquisition is part of the Company's plan to increase the levels of noninterest income and to complement the existing retirement services currently being offered.

Goodwill of $2.6 million, which is recorded on the balance sheet of NAI, arising from the acquisition consisted largely of synergies and the cost savings resulting from the combining of the operations of the companies. The goodwill is not expected to be deductible for income tax purposes. The fair value of other intangible assets of $2.3 million is related to client relationships, company name and noncompetition agreements. The following table summarizes the consideration paid for NAI and the amounts of the assets acquired and liabilities assumed.

(In Thousands of Dollars)	
Consideration	
Cash	$ 2,111
Stock	1,400
Contingent consideration	920
Fair value of total consideration transferred	$ 4,431
Assets acquired and liabilities assumed	
Cash	$ 28
Accounts receivable	300

Premises and equipment	50
Other assets	1
Total assets acquired	379
Liabilities assumed	81
Net assets acquired	$298
Assets and liabilities arising from acquisition	
Identified intangible assets	2,290
Deferred tax liability	(802)