AMERISERV FINANCIAL INC /PA/
Form 10-Q
November 09, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the period ended September 30, 2012

¨ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transaction period from to

Commission File Number 0-11204

AmeriServ Financial, Inc.

(Exact name of registrant as specified in its charter)

Pennsylvania	**25-1424278**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
Main & Franklin Streets, P.O. Box 430, Johnstown, PA	**15907-0430**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code (814) 533-5300

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. x Yes ¨ No

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

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

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

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

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 November 1, 2012
Common Stock, par value $0.01	19,255,221

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Item 1. Financial Statements

AmeriServ Financial, Inc.

CONSOLIDATED BALANCE SHEETS

(In thousands)

(Unaudited)

	September 30, 2012	December 31, 2011
ASSETS		
Cash and due from depository institutions	$ 19,462	$ 26,938
Interest bearing deposits	10,355	1,716
Short-term investments in money market funds	3,855	6,129
Total cash and cash equivalents	33,672	34,783
Investment securities:		
Available for sale	167,109	182,923
Held to maturity (fair value $14,868 on September 30, 2012 and $12,914 on December 31, 2011)	14,210	12,280
Loans held for sale	6,641	7,110
Loans	700,625	664,189
Less: Unearned income	642	452
Allowance for loan losses	12,829	14,623
Net loans	687,154	649,114
Premises and equipment, net	11,187	10,674
Accrued interest income receivable	3,403	3,216
Goodwill	12,613	12,613
Bank owned life insurance	35,996	35,351
Net deferred tax asset	10,592	12,681
Federal Home Loan Bank stock	4,808	5,891
Federal Reserve Bank stock	2,125	2,125
Prepaid federal deposit insurance	1,524	1,814
Other assets	11,247	8,501
TOTAL ASSETS	$ 1,002,281	$ 979,076
LIABILITIES		
Non-interest bearing deposits	$ 157,441	$ 141,982
Interest bearing deposits	692,684	674,438
Total deposits	850,125	816,420
Short-term borrowings		15,765
Advances from Federal Home Loan Bank	12,000	6,000
Guaranteed junior subordinated deferrable interest debentures	13,085	13,085
Total borrowed funds	25,085	34,850
Other liabilities	14,760	15,454

TOTAL LIABILITIES		889,970		866,724
SHAREHOLDERS EQUITY				
Preferred stock, no par value; $1,000 per share liquidation preference; 2,000,000 shares authorized; 21,000 shares issued and outstanding on September 30, 2012 and December 31, 2011		21,000		21,000
Common stock, par value $0.01 per share; 30,000,000 shares authorized; 26,398,540 shares issued and 19,255,221 outstanding on September 30, 2012; 26,397,040 shares issued and 20,921,021 outstanding on December 31, 2011		264		264
Treasury stock at cost, 7,143,319 shares on September 30, 2012 and 5,476,019 shares on December 31, 2011		(73,388)		(69,241)
Capital surplus		145,091		145,061
Retained earnings		22,457		18,928
Accumulated other comprehensive loss, net		(3,113)		(3,660)
TOTAL SHAREHOLDERS EQUITY		112,311		112,352
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$	1,002,281	$	979,076

See accompanying notes to unaudited consolidated financial statements.

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AmeriServ Financial, Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
INTEREST INCOME				
Interest and fees on loans	$ 8,807	$ 8,888	$ 26,088	$ 26,775
Interest bearing deposits	2	4	8	4
Short-term investments in money market funds	4	2	14	7
Federal funds sold				7
Investment securities:				
Available for sale	1,108	1,499	3,597	4,527
Held to maturity	109	99	332	298
Total Interest Income	10,030	10,492	30,039	31,618
INTEREST EXPENSE				
Deposits	1,587	2,038	5,017	6,438
Short-term borrowings	2	1	6	3
Advances from Federal Home Loan Bank	19	55	55	167
Guaranteed junior subordinated deferrable interest debentures	280	280	840	840
Total Interest Expense	1,888	2,374	5,918	7,448
NET INTEREST INCOME	8,142	8,118	24,121	24,170
Provision (credit) for loan losses	(200)	(550)	(1,325)	(2,325)
NET INTEREST INCOME AFTER PROVISION (CREDIT) FOR LOAN LOSSES	8,342	8,668	25,446	26,495
NON-INTEREST INCOME				
Trust fees	1,533	1,570	4,858	4,743
Investment advisory fees	182	172	552	568
Net realized gains (losses) on investment securities			12	(358)
Net gains on sale of loans	262	186	789	603
Service charges on deposit accounts	567	640	1,619	1,661
Bank owned life insurance	217	227	644	661
Other income	888	729	2,582	2,205
Total Non-Interest Income	3,649	3,524	11,056	10,083
NON-INTEREST EXPENSE				
Salaries and employee benefits	6,132	5,702	18,094	16,776
Net occupancy expense	698	680	2,129	2,179
Equipment expense	395	435	1,319	1,275
Professional fees	977	983	2,837	2,874
Supplies, postage and freight	191	203	624	662

Miscellaneous taxes and insurance	363	344	1,073	1,024
Federal deposit insurance expense	104	262	347	1,184
Other expense	1,227	1,273	3,845	3,704
Total Non-Interest Expense	10,087	9,882	30,268	29,678
PRETAX INCOME	1,904	2,310	6,234	6,900
Provision for income tax expense	597	744	1,930	2,133
NET INCOME	1,307	1,566	4,304	4,767
Preferred stock dividends and accretion of preferred stock discount	251	539	776	1,119
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	$ 1,056	$ 1,027	$ 3,528	$ 3,648
PER COMMON SHARE DATA:				
Basic:				
Net income	$ 0.05	$ 0.05	$ 0.18	$ 0.17
Average number of shares outstanding	19,275	21,208	19,844	21,208
Diluted:				
Net income	$ 0.05	$ 0.05	$ 0.18	$ 0.17
Average number of shares outstanding	19,351	21,227	19,904	21,231
Cash dividends declared	$ 0.00	$ 0.00	$ 0.00	$ 0.00

See accompanying notes to unaudited consolidated financial statements.

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AmeriServ Financial, Inc.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
COMPREHENSIVE INCOME				
Net income	$ 1,307	$ 1,566	$ 4,304	$ 4,767
Other comprehensive income, before tax:				
Pension obligation change for defined benefit plan	253	201	117	707
Income tax effect	(85)	(69)	(40)	(240)
Unrealized holding gains on available for sale securities arising during period	518	1,995	724	3,656
Income tax effect	(176)	(679)	(246)	(1,245)
Reclassification adjustment for losses (gains) on available for sale securities included in net income			(12)	358
Income tax effect			4	(123)
Other comprehensive income	510	1,448	547	3,113
Comprehensive income	$ 1,817	$ 3,014	$ 4,851	$ 7,880

See accompanying notes to unaudited consolidated financial statements.

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AmeriServ Financial, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine months ended September 30, 2012	Nine months ended September 30, 2011
OPERATING ACTIVITIES		
Net income	$ 4,304	$ 4,767
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision (credit) for loan losses	(1,325)	(2,325)
Depreciation expense	1,116	1,098
Net amortization of investment securities	847	463
Net realized (gains) losses on investment securities available for sale	(12)	358
Net gains on sale of loans	(789)	(603)
Amortization of deferred loan fees	(134)	(182)
Origination of mortgage loans held for sale	(58,359)	(39,021)
Sales of mortgage loans held for sale	59,617	42,866
Decrease (increase) in accrued interest income receivable	(187)	34
Decrease in accrued interest expense payable	(388)	(928)
Earnings on bank owned life insurance	(644)	(661)
Deferred income taxes	1,843	3,668
Stock based compensation expense	30	14
Decrease in prepaid Federal Deposit Insurance	290	1,120
Net (increase) decrease in other assets	(2,054)	2,893
Net decrease in other liabilities	(202)	(3,265)
Net cash provided by operating activities	3,953	10,296
INVESTING ACTIVITIES		
Purchases of investment securities - available for sale	(32,199)	(73,542)
Purchases of investment securities - held to maturity	(4,578)	(3,991)
Proceeds from sales of investment securities available for sale	4,221	16,518
Proceeds from maturities of investment securities available for sale	43,694	39,745
Proceeds from maturities of investment securities held to maturity	2,635	1,313
Proceeds from redemption of regulatory stock	1,083	1,031
Long-term loans originated	(148,238)	(98,583)
Principal collected on long-term loans	116,812	113,424
Loans purchased or participated	(14,492)	(8,500)
Loans sold or participated	8,500	
Sale of other real estate owned	110	797
Purchases of premises and equipment	(1,629)	(1,081)
Net cash used in investing activities	(24,081)	(12,869)
FINANCING ACTIVITIES		
Net increase in deposit balances	33,705	24,803
Net decrease in other short-term borrowings	(15,765)	(4,550)
Principal borrowings on advances from Federal Home Loan Bank	17,000	
Principal repayments on advances from Federal Home Loan Bank	(11,000)	(43)

Purchases of treasury stock		(4,147)		
Preferred stock dividends		(776)		(788)
Net cash provided by financing activities		19,017		19,422
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS		(1,111)		16,849
CASH AND CASH EQUIVALENTS AT JANUARY 1		34,783		19,337
CASH AND CASH EQUIVALENTS AT SEPTEMBER 30	$	33,672	$	36,186

See accompanying notes to unaudited consolidated financial statements.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. **Principles of Consolidation**

The accompanying consolidated financial statements include the accounts of AmeriServ Financial, Inc. (the Company) and its wholly-owned subsidiaries, AmeriServ Financial Bank (the Bank), AmeriServ Trust and Financial Services Company (the Trust Company), and AmeriServ Life Insurance Company (AmeriServ Life). The Bank is a Pennsylvania state-chartered full service Bank with 18 locations in Pennsylvania. The Trust Company offers a complete range of trust and financial services and administers assets valued at $1.5 billion that are not recognized on the Company s balance sheet at September 30, 2012. AmeriServ Life is a captive insurance company that engages in underwriting as a reinsurer of credit life and disability insurance.

In addition, the Parent Company is an administrative group that provides support in such areas as audit, finance, investments, loan review, general services, and marketing. Significant intercompany accounts and transactions have been eliminated in preparing the consolidated financial statements.

2. **Basis of Preparation**

The unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. In the opinion of management, all adjustments consisting only of normal recurring entries considered necessary for a fair presentation have been included. They are not, however, necessarily indicative of the results of consolidated operations for a full-year.

For further information, refer to the consolidated financial statements and accompanying notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

3. **Accounting Policies**

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.* The amendments in this Update result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments in this Update are to be applied prospectively. For public entities, the amendments were effective during interim and annual periods beginning after December 15, 2011. Early application by public entities was not permitted. Additional disclosures have been provided in Note 16.

In June 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income*. The amendments in this Update improve the comparability, clarity, consistency, and transparency of financial reporting and increase the prominence of items reported in other comprehensive income. To increase the prominence of items reported in other comprehensive income and to facilitate convergence of U.S. GAAP and IFRS, the option to present components of other comprehensive income as part of the statement of changes in stockholders equity was eliminated. The amendments require that all non-owner changes in stockholders equity be presented either in a

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single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. All entities that report items of comprehensive income, in any period presented, will be affected by the changes in this Update. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The amendments in this Update should be applied retrospectively. The Company has elected to provide the separate statement disclosure.

In September 2011, the FASB issued ASU 2011-08, *Intangibles Goodwill and Other Topics (Topic 350), Testing Goodwill for Impairment*. The objective of this Update is to simplify how entities, both public and nonpublic, test goodwill for impairment. The amendments in the Update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Under the amendments in this Update, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The amendments in this Update apply to all entities, both public and nonpublic, that have goodwill reported in their financial statements and are effective for interim and annual goodwill impairment tests performed for fiscal years beginning after December 15, 2011. This ASU did not have a significant impact on the Company s financial statements.

In December 2011, the FASB issued ASU 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. In order to defer only those changes in Update 2011-05 that relate to the presentation of reclassification adjustments, the paragraphs in this Update supersede certain pending paragraphs in Update 2011-05. Entities should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before Update 2011-05. All other requirements in Update 2011-05 are not affected by this Update, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. Public entities should apply these requirements for fiscal years, and interim periods within those years, beginning after December 15, 2011. This ASU did not have a significant impact on the Company s financial statements.

4. **Earnings Per Common Share**

Basic earnings per share include only the weighted average common shares outstanding. Diluted earnings per share include the weighted average common shares outstanding and any potentially dilutive common stock equivalent shares in the calculation. Treasury shares are treated as retired for earnings per share purposes. Options and warrants to purchase 182,351 common shares, at exercise prices ranging from $2.75 to $5.75, and 1,478,417 common shares, at exercise prices ranging from $2.20 to $6.10, were outstanding as of September 30, 2012 and 2011, respectively, but were not included in the computation of diluted earnings per common share because to do so would be antidilutive. Dividends and accretion of discount on preferred shares are deducted from net income in the calculation of earnings per common share.

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	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
	(In thousands, except per share data)			
Numerator:				
Net income	$ 1,307	$ 1,566	$ 4,304	$ 4,767
Preferred stock dividends and accretion of preferred stock discount	251	539	776	1,119
Net income available to common shareholders	$ 1,056	$ 1,027	$ 3,528	$ 3,648
Denominator:				
Weighted average common shares outstanding (basic)	19,275	21,208	19,844	21,208
Effect of stock options/warrants	76	19	60	23
Weighted average common shares outstanding (diluted)	19,351	21,227	19,904	21,231
Earnings per common share:				
Basic	$ 0.05	$ 0.05	$ 0.18	$ 0.17
Diluted	0.05	0.05	0.18	0.17

5. **Consolidated Statement of Cash Flows**

On a consolidated basis, cash and cash equivalents include cash and due from depository institutions, interest-bearing deposits, federal funds sold and short-term investments in money market funds**.** The Company made $122,000 in income tax payments in the first nine months of 2012 as compared to $69,000 for the first nine months of 2011. The Company made total interest payments of $6,306,000 in the first nine months of 2012 compared to $8,376,000 in the same 2011 period. The Company had non-cash transfers to other real estate owned (OREO) in the amounts of $836,000 and $58,000 in the first nine months of 2012 and 2011, respectively.

6. **Investment Securities**

The cost basis and fair values of investment securities are summarized as follows (in thousands):

Investment securities available for sale (AFS):

	September 30, 2012			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
US Agency	$ 6,848	$ 80	$	$ 6,928
US Agency mortgage- backed securities	145,796	7,460	(8)	153,248
Corporate bonds	6,991	12	(70)	6,933
Total	$ 159,635	$ 7,552	$ (78)	$ 167,109

Investment securities held to maturity (HTM):

September 30, 2012

Gross Gross

	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
US Agency mortgage- backed securities	$ 10,215	$ 738	$	$ 10,953
Corporate bonds and other securities	3,995		(80)	3,915
Total	$ 14,210	$ 738	$ (80)	$ 14,868

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Investment securities available for sale (AFS):

	December 31, 2011			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
US Agency	$ 10,689	$ 48	$ (28)	$ 10,709
US Agency mortgage- backed securities	165,484	6,737	(7)	172,214
Total	$ 176,173	$ 6,785	$ (35)	$ 182,923

Investment securities held to maturity (HTM):

	December 31, 2011			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
US Agency mortgage- backed securities	$ 9,280	$ 643	$	$ 9,923
Other securities	3,000		(9)	2,991
Total	$ 12,280	$ 643	$ (9)	$ 12,914

Maintaining investment quality is a primary objective of the Company s investment policy which, subject to certain limited exceptions, prohibits the purchase of any investment security below a Moody s Investor s Service or Standard & Poor s rating of A. At September 30, 2012, 93.7% of the portfolio was rated AAA as compared to 98.4% at December 31, 2011. 1.2% of the portfolio was either rated below A or unrated at September 30, 2012. The Company has no exposure to subprime mortgage loans in the investment portfolio. At September 30, 2012, the Company s consolidated investment securities portfolio had a modified duration of approximately 1.46 years. There were no sales of AFS securities in the third quarter of 2012. Total proceeds from the sale of AFS securities were $4.2 million for the first nine months of 2012. The Company had no gross investment security gains or gross investment security losses in the third quarter and $59,000 of gross investment security gains and $47,000 of gross investment security losses in the first nine months of 2012 compared to no gross investment security gains or losses in the third quarter of 2011 and $358,000 of gross investment security losses for the first nine months of 2011.

The book value of securities, both available for sale and held to maturity, pledged to secure public and trust deposits, and certain Federal Home Loan Bank borrowings was $89,663,000 at September 30, 2012 and $83,235,000 at December 31, 2011.

The following tables present information concerning investments with unrealized losses as of September 30, 2012 and December 31, 2011 (in thousands):

Investment securities available for sale:

	September 30, 2012					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Agency mortgage- backed securities	$ 1,024	$ (4)	$ 400	$ (4)	$ 1,424	$ (8)
Corporate bonds	5,929	(70)			5,929	(70)
Total	$ 6,953	$ (74)	$ 400	$ (4)	$ 7,353	$ (78)

Investment securities held to maturity:

	September 30, 2012					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate bonds and other securities	$ 1,942	$ (54)	$ 1,973	$ (26)	$ 3,915	$ (80)
Total	$ 1,942	$ (54)	$ 1,973	$ (26)	$ 3,915	$ (80)

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Investment securities available for sale:

	December 31, 2011					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Agency	$ 3,161	$ (28)	$	$	$ 3,161	$ (28)
US Agency mortgage- backed securities	613	(7)			613	(7)
Total	$ 3,774	$ (35)	$	$	$ 3,774	$ (35)

Investment securities held to maturity:

	December 31, 2011					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Other securities	$ 1,991	$ (9)	$	$	$ 1,991	$ (9)
Total	$ 1,991	$ (9)	$	$	$ 1,991	$ (9)

The unrealized losses are primarily a result of increases in market yields from the time of purchase. In general, as market yields rise, the value of securities will decrease; as market yields fall, the fair value of securities will increase. There are 11 positions that are considered temporarily impaired at September 30, 2012. Management generally views changes in fair value caused by changes in interest rates as temporary; therefore, these securities have not been classified as other-than-temporarily impaired. Management has also concluded that based on current information we expect to continue to receive scheduled interest payments as well as the entire principal balance. Furthermore, management does not intend to sell these securities and does not believe it will be required to sell these securities before they recover in value.

Contractual maturities of securities at September 30, 2012, are shown below (in thousands). Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without prepayment penalties.

Investment securities available for sale:

	September 30, 2012			
Cost Basis	US Agency	US Agency Mortgage- Backed Securities	Corporate Bonds	Total Investment Securities Available For Sale
After 1 year but within 5 years	$ 6,848	$	$ 6,991	$ 13,839
After 5 years but within 10 years		15,661		15,661
After 10 years but within15 years		65,666		65,666
Over 15 years		64,469		64,469
Total	$ 6,848	$ 145,796	$ 6,991	$ 159,635

	September 30, 2012			
Fair Value	US Agency	US Agency Mortgage-	Corporate Bonds	Total Investment Securities

		Backed Securities		Available For Sale
After 1 year but within 5 years	$ 6,928	$	$ 6,933	$ 13,861
After 5 years but within 10 years		16,562		16,562
After 10 years but within15 years		69,047		69,047
Over 15 years		67,639		67,639
Total	$ 6,928	$ 153,248	$ 6,933	$ 167,109

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Investment securities held to maturity:

Cost Basis	September 30, 2012 US Agency Mortgage-Backed Securities	Corporate Bonds and Other Securities	Total Investment Securities Held To Maturity
Within 1 year	$	$ 2,000	$ 2,000
After 1 year but within 5 years		1,000	1,000
Over 15 years	10,215	995	11,210
Total	$ 10,215	$ 3,995	$ 14,210

Fair Value	September 30, 2012 US Agency Mortgage-Backed Securities	Corporate Bonds and Other Securities	Total Investment Securities Held To Maturity
Within 1 year	$	$ 1,974	$ 1,974
After 1 year but within 5 years		961	961
Over 15 years	10,953	980	11,933
Total	$ 10,953	$ 3,915	$ 14,868

7. **Loans**

The loan portfolio of the Company consists of the following (in thousands):

	September 30, 2012	December 31, 2011
Commercial	$ 107,982	$ 83,124
Commercial loans secured by real estate	359,275	349,778
Real estate mortgage	215,869	212,663
Consumer	16,857	18,172
Loans, net of unearned income	$ 699,983	$ 663,737

Loan balances at September 30, 2012 and December 31, 2011 are net of unearned income of $642,000 and $452,000, respectively. Real estate-construction loans comprised 2.4%, and 1.9% of total loans, net of unearned income, at September 30, 2012 and December 31, 2011, respectively. The Company has no exposure to subprime mortgage loans in the loan portfolio.

8. **Allowance for Loan Losses**

The following tables summarize the rollforward of the allowance for loan losses by portfolio segment for the three month periods ending September 30, 2012 and 2011 (in thousands).

	Balance at June 30, 2012	Charge-Offs	Recoveries	Provision (Credit)	Balance at September 30, 2012
Commercial	$ 2,352	$ (246)	$ 14	$ 277	$ 2,397
Commercial loans secured by real estate	8,378		8	(515)	7,871
Real estate- mortgage	1,206	(51)	9	57	1,221
Consumer	155	(36)	14	17	150
Allocation for general risk	1,226			(36)	1,190
Total	$ 13,317	$ (333)	$ 45	$ (200)	$ 12,829

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	Balance at June 30, 2011	Charge-Offs	Recoveries	Provision (Credit)	Balance at September 30, 2011
Commercial	$ 4,554	$	$ 292	$ (386)	$ 4,460
Commercial loans secured by real estate	9,227	(646)	10	(99)	8,492
Real estate- mortgage	1,294	(5)	17	31	1,337
Consumer	193	(42)	35	10	196
Allocation for general risk	1,690			(106)	1,584
Total	$ 16,958	$ (693)	$ 354	$ (550)	$ 16,069

The following tables summarize the rollforward of the allowance for loan losses by portfolio segment for the nine month periods ending September 30, 2012 and 2011(in thousands).

	Balance at December 31, 2011	Charge-Offs	Recoveries	Provision (Credit)	Balance at September 30, 2012
Commercial	$ 2,365	$ (345)	$ 126	$ 251	$ 2,397
Commercial loans secured by real estate	9,400	(172)	208	(1,565)	7,871
Real estate- mortgage	1,270	(190)	38	103	1,221
Consumer	174	(170)	36	110	150
Allocation for general risk	1,414			(224)	1,190
Total	$ 14,623	$ (877)	$ 408	$ (1,325)	$ 12,829

	Balance at December 31, 2010	Charge-Offs	Recoveries	Provision (Credit)	Balance at September 30, 2011
Commercial	$ 3,851	$ (942)	$ 816	$ 735	$ 4,460
Commercial loans secured by real estate	12,717	(1,284)	76	(3,017)	8,492
Real estate- mortgage	1,117	(45)	43	222	1,337
Consumer	206	(152)	117	25	196
Allocation for general risk	1,874			(290)	1,584
Total	$ 19,765	$ (2,423)	$ 1,052	$ (2,325)	$ 16,069

The credit provision for loan losses reflects the Company s sustained asset quality improvements. The provision also benefited from lower historical loss factors and a decrease in certain qualitative factors to recognize the Company s improved asset quality.

The following tables summarize the loan portfolio and allowance for loan loss by the primary segments of the loan portfolio (in thousands).

	At September 30, 2012				
	Commercial	Commercial Loans Secured by Real Estate	Real Estate-Mortgage	Consumer	Total
Individually evaluated for impairment	$	$ 3,576	$	$	$ 3,576
Collectively evaluated for impairment	107,982	355,699	215,869	16,857	696,407
Total loans	$ 107,982	$ 359,275	$ 215,869	$ 16,857	$ 699,983

	At September 30, 2012					
	Commercial	Commercial Loans Secured by Real Estate	Real Estate-Mortgage	Consumer	Allocation for General Risk	Total
Specific reserve allocation	$	$ 987	$	$	$	$ 987
General reserve allocation	2,397	6,884	1,221	150	1,190	11,842
Total allowance for loan losses	$ 2,397	$ 7,871	$ 1,221	$ 150	$ 1,190	$ 12,829

	At December 31, 2011				
	Commercial	Commercial Loans Secured by Real Estate	Real Estate-Mortgage	Consumer	Total
Individually evaluated for impairment	$	$ 3,870	$	$	$ 3,870
Collectively evaluated for impairment	83,124	345,908	212,663	18,172	659,867
Total loans	$ 83,124	$ 349,778	$ 212,663	$ 18,172	$ 663,737

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	At December 31, 2011					
	Commercial	Commercial Loans Secured by Real Estate	Real Estate-Mortgage	Consumer	Allocation for General Risk	Total
Specific reserve allocation	$	$ 968	$	$	$	$ 968
General reserve allocation	2,365	8,432	1,270	174	1,414	13,655
Total allowance for loan losses	$ 2,365	$ 9,400	$ 1,270	$ 174	$ 1,414	$ 14,623

The segments of the Company s loan portfolio are disaggregated to a level that allows management to monitor risk and performance. The loan categories used are consistent with the internal reports evaluated by the Company s management and Board of Directors to monitor risk and performance within various segments of its loan portfolio. The overall risk profile for the commercial loan segment is driven by non-owner occupied CRE loans, which include loans secured by non-owner occupied nonfarm nonresidential properties, as the majority of the commercial portfolio is centered in these types of accounts. The residential mortgage loan segment is comprised of first lien amortizing residential mortgage loans and home equity loans. The consumer loan segment consists primarily of installment loans and overdraft lines of credit connected with customer deposit accounts.

Management evaluates for possible impairment any individual loan in the commercial segment with a loan balance in excess of $100,000 that is in nonaccrual status or classified as a Troubled Debt Restructure (TDR). Loans are considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. The Company does not separately evaluate individual consumer and residential mortgage loans for impairment, unless such loans are part of a larger relationship that is impaired, or are classified as a TDR.

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

The need for an updated appraisal on collateral dependent loans is determined on a case by case basis. The useful life of an appraisal or evaluation will vary depending upon the circumstances of the property and the economic conditions in the marketplace. A new appraisal is not required if there is an existing appraisal which, along with other information, is sufficient to determine a reasonable value for the property and to support an appropriate and adequate allowance for loan losses. At a minimum, annual documented reevaluation of the property is completed by the Bank s internal Assigned Risk Department to support the value of the property.

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When reviewing an appraisal associated with an existing collateral real estate dependent transaction, the Bank s internal Assigned Risk Department must determine if there have been material changes to the underlying assumptions in the appraisal which affect the original estimate of value. Some of the factors that could cause material changes to reported values include:

the passage of time;

the volatility of the local market;

the availability of financing;

natural disasters;

the inventory of competing properties;

new improvements to, or lack of maintenance of, the subject property or competing properties upon physical inspection by the Bank;

changes in underlying economic and market assumptions, such as material changes in current and projected vacancy, absorption rates, capitalization rates, lease terms, rental rates, sales prices, concessions, construction overruns and delays, zoning changes, etc.; and/or

environmental contamination.

The value of the property is adjusted to appropriately reflect the above listed factors and the value is discounted to reflect the value impact of a forced or distressed sale, any outstanding senior liens, any outstanding unpaid real estate taxes, transfer taxes and closing costs that would occur with sale of the real estate. If the Assigned Risk Department personnel determine that a reasonable value cannot be derived based on available information, a new appraisal is ordered. The determination of the need for a new appraisal, versus completion of a property valuation by the Bank s Assigned Risk Department personnel rests with the Assigned Risk Department and not the originating account officer.

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

	September 30, 2012				
	Impaired Loans with Specific Allowance		Impaired Loans with no Specific Allowance	Total Impaired Loans	
	Recorded Investment	Related Allowance	Recorded Investment	Recorded Investment	Unpaid Principal Balance
Commercial loans secured by real estate	$ 3,076	$ 987	$ 500	$ 3,576	$ 3,764
Total impaired loans	$ 3,076	$ 987	$ 500	$ 3,576	$ 3,764

	December 31, 2011				
	Impaired Loans with Specific Allowance		Impaired Loans with no Specific Allowance	Total Impaired Loans	
	Recorded Investment	Related Allowance	Recorded Investment	Recorded Investment	Unpaid Principal Balance
Commercial loans secured by real estate	$ 2,836	$ 968	$ 1,034	$ 3,870	$ 4,844
Total impaired loans	$ 2,836	$ 968	$ 1,034	$ 3,870	$ 4,844

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The following table presents the average recorded investment in impaired loans and related interest income recognized for the periods indicated (in thousands).

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Average loan balance:				
Commercial	$	$ 24	$ 17	$ 1,571
Commercial loans secured by real estate	3,576	4,313	3,680	5,985
Average investment in impaired loans	$ 3,576	$ 4,337	$ 3,697	$ 7,556
Interest income recognized:				
Commercial	$	$	$	$ 20
Commercial loans secured by real estate				153
Interest income recognized on a cash basis on impaired loans	$	$	$	$ 173

Management uses a ten point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized. The first five Pass categories are aggregated, while the Pass 6, Special Mention, Substandard and Doubtful categories are disaggregated to separate pools. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due, or for which any portion of the loan represents a specific allocation of the allowance for loan losses are placed in Substandard or Doubtful.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Company has a structured loan rating process, which dictates that, at a minimum, credit reviews are mandatory for all commercial and commercial mortgage loan relationships with aggregate balances in excess of $250,000 within a 12-month period. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as bankruptcy, delinquency, or death occurs to raise awareness of a possible credit event. The Company s commercial relationship managers are responsible for the timely and accurate risk rating of the loans in their portfolios at origination and on an ongoing basis. Risk ratings are assigned by the account officer, but require independent review and rating concurrence from the Company s internal Loan Review Department. The Loan Review Department is an experienced independent function which reports directly to the Board Audit Committee. The scope of commercial portfolio coverage by the Loan Review Department is defined and presented to the Audit Committee for approval on an annual basis. The approved scope of coverage for 2012 requires review of a minimum 55% of the commercial loan portfolio.

In addition to loan monitoring by the account officer and Loan Review Department, the Company also requires presentation of all credits rated Pass-6 with aggregate balances greater than $1,000,000, all credits rated Special Mention or Substandard with aggregate balances greater than $250,000, and all credits rated Doubtful with aggregate balances greater than $100,000 on an individual basis to the Company s Loan Loss Reserve Committee on a quarterly basis.

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The following table presents the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard and Doubtful within the internal risk rating system (in thousands).

	September 30, 2012				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 107,502	$ 37	$ 443	$	$ 107,982
Commercial loans secured by real estate	318,252	21,040	19,630	353	359,275
Total	$ 425,754	$ 21,077	$ 20,073	$ 353	$ 467,257

	December 31, 2011				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 80,175	$ 2,186	$ 763	$	$ 83,124
Commercial loans secured by real estate	305,066	28,138	16,244	330	349,778
Total	$ 385,241	$ 30,324	$ 17,007	$ 330	$ 432,902

It is generally the policy of the Bank that the outstanding balance of any residential mortgage loan that exceeds 90-days past due as to principal and/or interest is transferred to non-accrual status and an evaluation is completed to determine the fair value of the collateral less selling costs, unless the balance is minor. A charge down is recorded for any deficiency balance determined from the collateral evaluation. The remaining non-accrual balance is reported as impaired with no specific allowance. It is the policy of the Bank that the outstanding balance of any consumer loan that exceeds 90-days past due as to principal and/or interest is charged off. The following tables present the performing and non-performing outstanding balances of the residential and consumer portfolios (in thousands).

	September 30, 2012	
	Performing	Non-Performing
Real estate- mortgage	$ 213,825	$ 2,044
Consumer	16,857	
Total	$ 230,682	$ 2,044

	December 31, 2011	
	Performing	Non-Performing
Real estate- mortgage	$ 211,458	$ 1,205
Consumer	18,172	
Total	$ 229,630	$ 1,205

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans (in thousands).

	September 30, 2012						
	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days Past Due	Total Past Due	Total Loans	90 Days Past Due and Still Accruing
Commercial	$ 107,757	$ 225	$	$	$ 225	$ 107,982	$
Commercial loans secured by real estate	357,736	579		960	1,539	359,275	
Real estate- mortgage	213,402	1,779	606	82	2,467	215,869	
Consumer	16,832	11	14		25	16,857	
Total	$ 695,727	$ 2,594	$ 620	$ 1,042	$ 4,256	$ 699,983	$

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	December 31, 2011						
	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days Past Due	Total Past Due	Total Loans	90 Days Past Due and Still Accruing
Commercial	$ 83,124	$	$	$	$	$ 83,124	$
Commercial loans secured by real estate	347,671	650		1,457	2,107	349,778	
Real estate- mortgage	209,060	2,133	629	841	3,603	212,663	
Consumer	18,115	57			57	18,172	
Total	$ 657,970	$ 2,840	$ 629	$ 2,298	$ 5,767	$ 663,737	$

An allowance for loan losses (ALL) is maintained to absorb losses from the loan portfolio. The ALL is based on management s continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of non-performing loans.

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are complemented by consideration of other qualitative factors.

Management tracks the historical net charge-off activity at each risk rating grade level for the entire commercial portfolio and at the aggregate level for the consumer, residential mortgage and small business portfolios. A historical charge-off factor is calculated utilizing a rolling 12 consecutive historical quarters for the commercial portfolios. This historical charge-off factor for the consumer, residential mortgage and small business portfolios are based on a three year historical average of actual loss experience.

The Company uses a comprehensive methodology and procedural discipline to maintain an ALL to absorb inherent losses in the loan portfolio. The Company believes this is a critical accounting policy since it involves significant estimates and judgments. The allowance consists of three elements: 1) an allowance established on specifically identified problem loans, 2) formula driven general reserves established for loan categories based upon historical loss experience and other qualitative factors which include delinquency, non-performing and TDR loans, loan trends, economic trends, concentrations of credit, trends in loan volume, experience and depth of management, examination and audit results, effects of any changes in lending policies, and trends in policy, financial information, and documentation exceptions, and 3) a general risk reserve which provides support for variance from our assessment of the previously listed qualitative factors, provides protection against credit risks resulting from other inherent risk factors contained in the Company s loan portfolio, and recognizes the model and estimation risk associated with the specific and formula driven allowances. The qualitative factors used in the formula driven general reserves are evaluated quarterly (and revised if necessary) by the Company s management to establish allocations which accommodate each of the listed risk factors.

Pass rated credits are segregated from Criticized and Classified credits for the application of qualitative factors.

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALLL.

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9. **Non-performing Assets Including Troubled Debt Restructurings (TDR)**

The following table presents information concerning non-performing assets including TDR (in thousands, except percentages):

	September 30, 2012	December 31, 2011
Non-accrual loans		
Commercial	$	$
Commercial loans secured by real estate	2,411	3,870
Real estate-mortgage	2,044	1,205
Total	4,455	5,075
Other real estate owned		
Commercial loans secured by real estate	697	20
Real estate-mortgage	133	104
Total	830	124
TDR s not in non-accrual	87	
Total non-performing assets including TDR	$ 5,372	$ 5,199
Total non-performing assets as a percent of loans, net of unearned income, and other real estate owned	0.77%	0.78%

Consistent with accounting and regulatory guidance, the Bank recognizes a TDR when the Bank, for economic or legal reasons related to a borrower s financial difficulties, grants a concession to the borrower that would not normally be considered. Regardless of the form of concession granted, the Bank s objective in offering a troubled debt restructure is to increase the probability of repayment of the borrower s loan.

To be considered a TDR, both of the following criteria must be met:

- the borrower must be experiencing financial difficulties; and
- the Bank, for economic or legal reasons related to the borrower s financial difficulties, grants a concession to the borrower that would not otherwise be considered.

Factors that indicate a borrower is experiencing financial difficulties include, but are not limited to:

- the borrower is currently in default on their loan(s);