MIDDLEFIELD BANC CORP
Form 10-Q
May 15, 2012

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20552**

# FORM 10-Q

## QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE

## SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2012

**For the quarterly period ended March 31, 2012**

**Commission File Number 000-32561**

# Middlefield Banc Corp.

**(Exact name of registrant as specified in its charter)**

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

**15985 East High Street, Middlefield, Ohio 44062-9263**

**(Address of principal executive offices)**

**(440) 632-1666**

**(Registrant s telephone number, including area code)**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES 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 the definition of large accelerated filer , accelerated filer , and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

| | | | |
|---|---|---|---|
| Large accelerated filer | ¨ | Accelerated filer | ¨ |
| Non-accelerated filer | ¨ | Small reporting company | x |

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

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

**Class: Common Stock, without par value**

**Outstanding at May 15, 2012: 1,970,044**

**MIDDLEFIELD BANC CORP.**

**INDEX**

MIDDLEFIELD BANC CORP.

CONSOLIDATED BALANCE SHEET

(Dollar amounts in thousands)

(Unaudited)

| | March 31, 2012 | December 31, 2011 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 22,022 | $ 15,730 |
| Federal funds sold | 23,587 | 18,660 |
| Cash and cash equivalents | 45,609 | 34,390 |
| Investment securities available for sale | 183,770 | 193,977 |
| Loans | 404,269 | 401,880 |
| Less allowance for loan losses | 7,267 | 6,819 |
| Net loans | 397,002 | 395,061 |
| Premises and equipment | 8,368 | 8,264 |
| Goodwill | 4,559 | 4,559 |
| Bank-owned life insurance | 8,326 | 8,257 |
| Accrued interest and other assets | 10,315 | 10,043 |
| TOTAL ASSETS | $ 657,949 | $ 654,551 |
| LIABILITIES | | |
| Deposits: | | |
| Noninterest-bearing demand | $ 64,517 | $ 63,348 |
| Interest-bearing demand | 63,509 | 55,853 |
| Money market | 71,047 | 75,621 |
| Savings | 172,236 | 167,207 |
| Time | 212,633 | 218,933 |
| Total deposits | 583,942 | 580,962 |
| Short-term borrowings | 7,365 | 7,392 |
| Other borrowings | 16,561 | 16,831 |
| Accrued interest and other liabilities | 1,622 | 2,113 |
| TOTAL LIABILITIES | 609,490 | 607,298 |
| STOCKHOLDERS EQUITY | | |
| Common stock, no par value; 10,000,000 shares authorized, 1,961,217 and 1,951,868 shares issued | 31,420 | 31,240 |
| Retained earnings | 19,272 | 18,206 |
| Accumulated other comprehensive income | 4,501 | 4,541 |
| Treasury stock, at cost; 189,530 shares | (6,734) | (6,734) |
| TOTAL STOCKHOLDERS EQUITY | 48,459 | 47,253 |
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | $ 657,949 | $ 654,551 |

See accompanying notes to the unaudited consolidated financial statements.

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MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF INCOME

(Dollar amounts in thousands, except per share data)

(Unaudited)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2012 | 2011 |
| INTEREST INCOME | | |
| Interest and fees on loans | $ 5,537 | $ 5,301 |
| Interest-bearing deposits in other institutions | 4 | 2 |
| Federal funds sold | 3 | 9 |
| Investment securities: | | |
| Taxable interest | 915 | 1,323 |
| Tax-exempt interest | 747 | 698 |
| Dividends on stock | 26 | 26 |
| Total interest income | 7,232 | 7,359 |
| INTEREST EXPENSE | | |
| Deposits | 1,497 | 2,037 |
| Short term borrowings | 59 | 59 |
| Other borrowings | 84 | 109 |
| Trust preferred debt | 46 | 136 |
| Total interest expense | 1,686 | 2,341 |
| NET INTEREST INCOME | 5,546 | 5,018 |
| Provision for loan losses | 600 | 865 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 4,946 | 4,153 |
| NONINTEREST INCOME | | |
| Service charges on deposit accounts | 431 | 428 |
| Investment securities gains, net | | 15 |
| Earnings on bank-owned life insurance | 68 | 73 |
| Other income | 295 | 183 |
| Total noninterest income | 794 | 699 |
| NONINTEREST EXPENSE | | |
| Salaries and employee benefits | 1,750 | 1,690 |
| Occupancy expense | 248 | 272 |
| Equipment expense | 170 | 158 |
| Data processing costs | 199 | 180 |
| Ohio state franchise tax | 129 | 128 |
| Federal deposit insurance expense | 243 | 225 |
| Professional fees | 214 | 211 |
| Loss (gain) on sale of other real estate owned | 18 | (20) |
| Other expense | 811 | 861 |
| Total noninterest expense | 3,782 | 3,705 |

| | | |
|---|---|---|
| Income before income taxes | 1,958 | 1,147 |
| Income taxes | 435 | 145 |
| NET INCOME | $ 1,523 | $ 1,002 |
| EARNINGS PER SHARE | | |
| Basic | $ 0.86 | $ 0.62 |
| Diluted | 0.86 | 0.62 |
| DIVIDENDS DECLARED PER SHARE | $ 0.26 | $ 0.26 |

See accompanying notes to the unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(Dollar amounts in thousands)

(Unaudited)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2012 | 2011 |
| Net income | $ 1,523 | $ 1,002 |
| Other comprehensive loss: | | |
| Net unrealized holding loss on available for sale securities | (60) | (246) |
| Tax effect | 20 | 82 |
| Reclassification adjustment for gains included in net income | | (15) |
| Tax effect | | 5 |
| Total other comprehensive loss | (40) | (174) |
| Comprehensive income | $ 1,483 | $ 828 |

See accompanying notes to the unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

(Dollar amounts in thousands, except dividend per share amount)

(Unaudited)

| | Common Stock | Retained Earnings | Accumulated Other Comprehensive Income | Treasury Stock | Total Stockholders Equity |
|---|---|---|---|---|---|
| Balance, December 31, 2011 | $ 31,240 | $ 18,206 | $ 4,541 | $ (6,734) | $ 47,253 |
| Net income | | 1,523 | | | 1,523 |
| Comprehensive loss | | | (40) | | (40) |
| Dividend reinvestment and purchase plan (9,349 shares) | 180 | | | | 180 |
| Cash dividends ($0.26 per share) | | (457) | | | (457) |
| Balance, March 31, 2012 | $ 31,420 | $ 19,272 | $ 4,501 | $ (6,734) | $ 48,459 |

See accompanying notes to the unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF CASH FLOWS

(Dollar amounts in thousands)

(Unaudited)

| | Three Months Ended March 31, 2012 | 2011 |
|---|---|---|
| OPERATING ACTIVITIES | | |
| Net income | $ 1,523 | $ 1,002 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 600 | 865 |
| Investment securities gains, net | | (15) |
| Depreciation and amortization | 221 | 211 |
| Amortization of premium and discount on investment securities | 224 | 116 |
| Amortization of deferred loan fees, net | (55) | (40) |
| Earnings on bank-owned life insurance | (68) | (73) |
| Deferred income taxes | (28) | (384) |
| Loss (gain) on sale of other real estate owned | 18 | (20) |
| Gain on sale of loans | (85) | |
| Increase in accrued interest receivable | (442) | (487) |
| Decrease in accrued interest payable | (104) | (31) |
| Decrease in prepaid federal deposit insurance | 211 | 225 |
| Other, net | (438) | (338) |
| Net cash provided by operating activities | 1,577 | 1,031 |
| INVESTING ACTIVITIES | | |
| Investment securities available for sale: | | |
| Proceeds from repayments and maturities | 18,533 | 10,135 |
| Proceeds from sale of securities | | 14,879 |
| Purchases | (8,611) | (13,247) |
| Increase in loans, net | (2,643) | (4,487) |
| Proceeds from the sale of other real estate owned | 210 | 170 |
| Purchase of premises and equipment | (253) | (26) |
| Net cash provided by investing activities | 7,236 | 7,423 |
| FINANCING ACTIVITIES | | |
| Net increase in deposits | 2,980 | 3,353 |
| Decrease in short-term borrowings, net | (27) | (331) |
| Repayment of other borrowings | (270) | (365) |
| Common stock issuance | | 666 |
| Proceeds from dividend reinvestment & purchase plan | 180 | 148 |
| Cash dividends | (457) | (424) |
| Net cash provided by financing activities | 2,406 | 3,047 |
| Increase in cash and cash equivalents | 11,219 | 11,501 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 34,390 | 30,635 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | $ 45,609 | $ 42,136 |

| | | |
|---|---|---|
| SUPPLEMENTAL INFORMATION | | |
| Cash paid during the year for: | | |
| Interest on deposits and borrowings | $ 1,790 | $ 2,372 |
| Income taxes | 200 | 850 |
| Non-cash investing transactions: | | |
| Transfers from loans to other real estate owned | $ 157 | $ 96 |

See accompanying notes to the unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 1 BASIS OF PRESENTATION**

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

The accompanying financial statements have been prepared in accordance with U.S. generally accepted accounting principles and the instructions for Form 10-Q and Article 10 of Regulation S-X. In management s opinion, the financial statements include all adjustments, consisting of normal recurring adjustments, that the Company considers necessary to fairly state the Company s financial position and the results of operations and cash flows. The consolidated balance sheet at December 31, 2011, has been derived from the audited financial statements at that date but does not include all of the necessary informational disclosures and footnotes as required by U. S. generally accepted accounting principles. The accompanying financial statements should be read in conjunction with the financial statements and notes thereto included with Middlefield s Form 10-K for the year ended December 31, 2011 (File No. 000-32561). The results of Middlefield s operations for any interim period are not necessarily indicative of the results of Middlefield s operations for any other interim period or for a full fiscal year.

Recent Accounting Pronouncements

In April 2011, the Financial Accounting Standards Board ( FASB ) issued ASU 2011-03, *Transfers and Services (Topic 860): Reconsideration of Effective Control for Repurchase Agreements*. The main objective in developing this Update is to improve the accounting for repurchase agreements (repos) and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The amendments in this Update remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. The amendments in this Update apply to all entities, both public and nonpublic. The amendments affect all entities that enter into agreements to transfer financial assets that both entitle and obligate the transferor to repurchase or redeem the financial assets before their maturity. The guidance in this Update is effective for the first interim or annual period beginning on or after December 15, 2011 and should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. This ASU is not expected to have a significant impact on the Company s financial statements.

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 are effective during interim and annual periods beginning after December 15, 2011. For nonpublic entities, the amendments are effective for annual periods beginning after December 15, 2011. Early application by public entities is not permitted. The Company has provided the necessary disclosures in Note 4.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220): 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 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. For nonpublic entities, the amendments are effective for fiscal years ending after December 15, 2012, and interim and annual periods thereafter. The amendments in this Update should be applied retrospectively, and early adoption is permitted. The Company has provided the necessary disclosure in the Consolidated Statement of Comprehensive Income.

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. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity s financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance. This ASU did not have a significant impact on the Company s financial statements.

In December 2011, the FASB issued ASU 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities*. The amendments in this Update affect all entities that have financial instruments and derivative instruments that are either (1) offset in accordance with either Section 210-20-45 or Section 815-10-45 or (2) subject to an enforceable master netting arrangement or similar agreement. The requirements amend the disclosure requirements on offsetting in Section 210-20-50. This information will enable users of an entity s financial statements to evaluate the effect or potential effect of netting arrangements on an entity s financial position, including the effect or potential effect of rights of setoff associated with certain financial instruments and derivative instruments in the scope of this Update. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. This ASU is not expected to 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. Nonpublic entities should begin applying these requirements for fiscal years ending after December 15, 2012, and interim and annual periods thereafter. This ASU is not expected to have a significant impact on the Company s financial statements.

**NOTE 2 STOCK-BASED COMPENSATION**

The Company has 9,000 unvested stock options outstanding but no unrecognized stock-based compensation costs outstanding as of March 31, 2012. The unvested options are scheduled to vest on May 9, 2012.

Stock option activity during the three months ended March 31, 2012 and 2011 is as follows:

| | 2012 | Weighted-average Exercise Price | 2011 | Weighted-average Exercise Price |
|---|---|---|---|---|
| Outstanding, January 1 | 88,774 | $ 26.81 | 89,077 | $ 27.87 |
| Granted | | | | |
| Exercised | | | | |
| Forfeited | | | (7,549) | 29.22 |
| Outstanding, March 31 | 88,774 | $ 26.81 | 81,528 | $ 27.75 |

**NOTE 3 EARNINGS PER SHARE**

The Company provides dual presentation of Basic and Diluted earnings per share. Basic earnings per share uses net income as reported as the numerator and the actual average shares outstanding as the denominator. Diluted earnings per share includes any dilutive effects of options, warrants, and convertible securities.

There are no convertible securities that would affect the denominator in calculating basic and diluted earnings per share. The following tables set forth the composition of the weighted-average common shares (denominator) used in the basic and diluted earnings per share computation.

| | For the Three Months Ended March 31, | |
|---|---|---|
| | 2012 | 2011 |
| Weighted average common shares outstanding | 1,953,512 | 1,811,419 |
| Average treasury stock shares | (189,530) | (189,530) |
| Weighted average common shares and common stock equivalents used to calculate basic earnings per share | 1,763,982 | 1,621,889 |
| Additional common stock equivalents (stock options) used to calculate diluted earnings per share | 603 | |
| Weighted average common shares and common stock equivalents used to calculate diluted earnings per share | 1,764,585 | 1,621,889 |

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

Options to purchase 81,528 shares of common stock at prices ranging from $22.33 to $40.24 were outstanding during the three months ended March 31, 2011 but were not included in the computation of diluted earnings per share as they were anti-dilutive due to the strike price being greater than the market price as of March 31, 2011.

**NOTE 4 FAIR VALUE MEASUREMENTS**

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

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

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

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

The following tables present the assets measured on a recurring basis on the Consolidated Balance Sheet at their fair value as of March 31, 2012 and December 31, 2011 by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

| | March 31, 2012 | | | |
|---|---|---|---|---|
| (Dollar amounts in thousands) | Level I | Level II | Level III | Total |
| Assets measured on a recurring basis: | | | | |
| U.S. government agency securities | $ | $ 20,543 | $ | $ 20,543 |
| Obligations of states and political subdivisions | | 87,620 | | 87,620 |
| Mortgage-backed securities in government-sponsored entities | | 68,060 | | 68,060 |
| Private-label mortgage-backed securities | | 6,796 | | 6,796 |
| Total debt securities | | 183,019 | | 183,019 |
| Equity securities in financial institutions | 5 | 746 | | 751 |
| Total | $ 5 | $ 183,765 | $ | $ 183,770 |

| | December 31, 2011 | | | |
|---|---|---|---|---|
| | Level I | Level II | Level III | Total |
| Assets measured on a recurring basis: | | | | |
| U.S. government agency securities | $ | $ 31,933 | $ | $ 31,933 |
| Obligations of states and political subdivisions | | 88,400 | | 88,400 |
| Mortgage-backed securities in government- sponsored entities | | 65,573 | | 65,573 |
| Private-label mortgage-backed securities | | 7,321 | | 7,321 |
| Total debt securities | | 193,227 | | 193,227 |
| Equity securities in financial institutions | 5 | 745 | | 750 |
| Total | $ 5 | $ 193,972 | $ | $ 193,977 |

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

Financial instruments are considered Level III when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. In addition to these unobservable inputs, the valuation models for Level III financial instruments typically also rely on a number of inputs that are readily observable either directly or indirectly. Level III financial instruments also include those for which the determination of fair value requires significant management judgment or estimation. The Company has no securities considered to be Level III as of March 31, 2012.

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

The following tables present the assets measured on a nonrecurring basis on the Consolidated Balance Sheet at their fair value as of March 31, 2012 and December 31, 2011, by level within the fair value hierarchy. Impaired loans that are collateral dependent are written down to fair value through the establishment of specific reserves. Techniques used to value the collateral that secure the impaired loan include: quoted market prices for identical assets classified as Level I inputs; observable inputs, employed by certified appraisers, for similar assets classified as Level II inputs. In cases where valuation techniques included inputs that are unobservable and are based on estimates and assumptions developed by management based on the best information available under each circumstance, the asset valuation is classified as Level III inputs.

| (Dollar amounts in thousands) | Level I | Level II | Level III | Total |
|---|---|---|---|---|
| | March 31, 2012 | | | |
| Assets measured on a recurring basis: | | | | |
| Impaired loans | $ | $ | $ 5,798 | $ 5,798 |
| Other real estate owned | | | 2,125 | 2,125 |

| | Level I | Level II | Level III | Total |
|---|---|---|---|---|
| | December 31, 2011 | | | |
| Assets measured on a recurring basis: | | | | |
| Impaired loans | $ | $ | $ 13,581 | $ 13,581 |
| Other real estate owned | | | 2,196 | 2,196 |

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

| *(unaudited, in thousands)* | Quantitative Information about Level III Fair Value Measurements | | | |
|---|---|---|---|---|
| March 31, 2012 | Estimate | Valuation Techniquest | Unobservable Input | Range (Weighted Average) |
| Impaired loans | $ 5,798 | Appraisal of collateral (1) | Appraisal adjustments (2) | 0% to -50.0% (-36.1%) |
| | | | Liquidation expenses (2) | 0% to 42.7% (-3.3%) |
| Other real estate owned | $ 2,125 | Appraisal of collateral (1), (3) | | |

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

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

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

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

| | March 31, 2012 | | | | |
|---|---|---|---|---|---|
| | Carrying Value | Level I | Level II | Level III | Total Fair Value |
| | | | (in thousands) | | |
| Financial assets: | | | | | |
| Cash and cash equivalents | $ 45,609 | $ 45,609 | $ | $ | $ 45,609 |
| Investment securities | | | | | |
| Available for sale | 183,770 | 5 | 183,765 | | 183,770 |
| Net loans | 397,002 | | | 384,755 | 384,755 |
| Bank-owned life insurance | 8,326 | 8,326 | | | 8,326 |
| Federal Home Loan Bank stock | 1,887 | 1,887 | | | 1,887 |
| Accrued interest receivable | 2,676 | 2,676 | | | 2,676 |
| Financial liabilities: | | | | | |
| Deposits | $ 583,942 | $ 371,308 | $ | $ 218,353 | $ 589,661 |
| Short-term borrowings | 7,365 | 7,365 | | | 7,365 |
| Other borrowings | 16,561 | | | 16,999 | 16,999 |
| Accrued interest payable | 541 | 541 | | | 541 |

| | March 31, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| | | (in thousands) | | |
| Financial assets: | | | | |
| Cash and cash equivalents | $ 45,609 | $ 45,609 | $ 34,390 | $ 34,390 |
| Investment securities | | | | |
| Available for sale | 183,770 | 183,770 | 193,977 | 193,977 |
| Net loans | 397,002 | 384,755 | 395,061 | 382,542 |
| Bank-owned life insurance | 8,326 | 8,326 | 8,257 | 8,257 |
| Federal Home Loan Bank stock | 1,887 | 1,887 | 1,887 | 1,887 |
| Accrued interest receivable | 2,676 | 2,676 | 2,234 | 2,234 |
| Financial liabilities: | | | | |
| Deposits | $ 583,942 | $ 589,661 | $ 580,962 | $ 587,178 |
| Short-term borrowings | 7,365 | 7,365 | 7,392 | 7,392 |
| Other borrowings | 16,561 | 16,999 | 16,831 | 17,327 |
| Accrued interest payable | 541 | 541 | 645 | 645 |

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

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

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

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

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

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

The fair value is equal to the current carrying value.

**Bank-Owned Life Insurance**

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

**Investment Securities Available for Sale**

The fair value of investment securities is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities. Fair value for certain private-label collateralized mortgage obligations were determined utilizing discounted cash flow models, due to the absence of a current market to provide reliable market quotes for the instruments.

**Loans**

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

**Deposits and Other Borrowed Funds**

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

**Commitments to Extend Credit**

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

**NOTE 5 INVESTMENT SECURITIES AVAILABLE FOR SALE**

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

| | March 31, 2012 | | | |
|---|---|---|---|---|
| (Dollar amounts in thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| U.S. government agency securities | $ 20,162 | $ 399 | $ (18) | $ 20,543 |
| Obligations of states and political subdivisions: | | | | |
| Taxable | 8,204 | 646 | | 8,850 |
| Tax-exempt | 75,123 | 3,691 | (44) | 78,770 |
| Mortgage-backed securities in government-sponsored entities | 66,350 | 1,761 | (51) | 68,060 |
| Private-label mortgage backed securities | 6,361 | 467 | (32) | 6,796 |
| Total debt securities | 176,200 | 6,964 | (145) | 183,019 |
| Equity securities in financial institutions | 750 | 1 | | 751 |
| Total | $ 176,950 | $ 6,965 | $ (145) | $ 183,770 |

| | December 31, 2011 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| U.S. government agency securities | $ 31,520 | $ 427 | $ (14) | $ 31,933 |
| Obligations of states and political subdivisions: | | | | |
| Taxable | 8,207 | 766 | | 8,973 |
| Tax-exempt | 75,807 | 3,681 | (61) | 79,427 |
| Mortgage-backed securities in government-sponsored entities | 63,808 | 1,819 | (54) | 65,573 |
| Private-label mortgage-backed securities | 7,005 | 411 | (95) | 7,321 |
| Total debt securities | 186,347 | 7,104 | (224) | 193,227 |
| Equity securities in financial institutions | 750 | | | 750 |
| Total | $ 187,097 | $ 7,104 | $ (224) | $ 193,977 |

The amortized cost and fair value of debt securities at March 31, 2012, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| (Dollar amounts in thousands) | Amortized Cost | Fair Value |
|---|---|---|
| Due in one year or less | $ 2,303 | $ 2,353 |
| Due after one year through five years | 4,769 | 5,065 |
| Due after five years through ten years | 17,911 | 18,745 |
| Due after ten years | 151,217 | 156,856 |
| Total | $ 176,200 | $ 183,019 |

There were no sales of investment securities available for sale during the three-months ended March 31, 2012. Proceeds from the sales of investment securities available for sale were $14.9 million during the three-months ended March 31, 2011. Gross gains realized were $15,000 during the three-months ended March 31, 2011.

Investment securities with an approximate carrying value of $52,126,000 and $47,187,000 at March 31, 2012 and 2011, respectively, were pledged to secure deposits and other purposes as required by law.

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

| | March 31, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Less than Twelve Months | | Twelve Months or Greater | | Total | |
| (Dollar amounts in thousands) | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| U.S. government agency securities | $ 980 | $ (18) | $ | $ | $ 980 | $ (18) |
| Obligations of states and political subdivisions | 1,091 | (19) | 532 | (25) | 1,623 | (44) |
| Mortgage-backed securities in government-sponsored entities | 9,407 | (51) | | | 9,407 | (51) |
| Private-label mortgage-backed securities | | | 396 | (32) | 396 | (32) |
| Total | $ 11,478 | $ (88) | $ 928 | $ (57) | $ 12,406 | $ (145) |