

AMERISERV FINANCIAL INC /PA/

Form 10-Q

November 07, 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 period ended **September 30, 2014**

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

Commission File Number **0-11204**

**AmeriServ Financial, Inc.**

(Exact name of registrant as specified in its charter)

Pennsylvania  
(State or other jurisdiction of  
incorporation or organization)

25-1424278  
(I.R.S. Employer  
Identification No.)

Edgar Filing: AMERISERV FINANCIAL INC /PA/ - Form 10-Q

Main & Franklin Streets,  
P.O. Box 430, Johnstown, PA  
(Address of principal executive offices)

15907-0430  
(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. 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). 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   
Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).  
Yes  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 3, 2014 |
|--------------------------------|---------------------------------|
| Common Stock, par value \$0.01 | 18,794,888                      |

TABLE OF CONTENTS

**AmeriServ Financial, Inc.**

**INDEX**

|  | Page<br>No. |
|--|-------------|
| PART I.  |             |
| FINANCIAL INFORMATION:   |             |
| <b><u>Item 1.</u></b>  | <u>1</u>    |
| <u>Financial Statements</u>  |             |
| <u>Consolidated Balance Sheets (Unaudited) September 30, 2014 and December 31, 2013</u>                                    | <u>1</u>    |
| <u>Consolidated Statements of Operations (Unaudited) Three and nine months ended September 30, 2014 and 2013</u>           | <u>2</u>    |
| <u>Consolidated Statements of Comprehensive Income (Unaudited) Three and nine months ended September 30, 2014 and 2013</u> | <u>4</u>    |
| <u>Consolidated Statements of Cash Flows (Unaudited) Nine months ended September 30, 2014 and 2013</u>                     | <u>5</u>    |
| <u>Notes to Unaudited Consolidated Financial Statements</u>  | <u>7</u>    |
| <b><u>Item 2.</u></b>  | <u>32</u>   |
| <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                               |             |
| <b><u>Item 3.</u></b>  | <u>47</u>   |
| <u>Quantitative and Qualitative Disclosure About Market Risk</u>   |             |
| <b><u>Item 4.</u></b>  | <u>47</u>   |
| <u>Controls and Procedures</u>   |             |
| PART II.   |             |
| OTHER INFORMATION  |             |
| <b><u>Item 1.</u></b>  | <u>48</u>   |
| <u>Legal Proceedings</u>   |             |
| <b><u>Item 1A.</u></b>   | <u>48</u>   |
| <u>Risk Factors</u>  |             |
| <b><u>Item 2.</u></b>  | <u>48</u>   |
| <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>   |             |
| <b><u>Item 3.</u></b>  | <u>48</u>   |

Defaults Upon Senior Securities

**Item 4.**

48

Mine Safety Disclosures

**Item 5.**

48

Other Information

**Item 6.**

48

Exhibits

i

---

TABLE OF CONTENTS

## Item 1. Financial Statements

### AmeriServ Financial, Inc.

**CONSOLIDATED BALANCE SHEETS**

(In thousands except shares)

(Unaudited)

|   | September<br>30,<br>2014 | December<br>31,<br>2013 |
|---|--------------------------|-------------------------|
| <b>ASSETS</b>   |                          |                         |
| Cash and due from depository institutions   | \$16,820                 | \$20,288                |
| Interest bearing deposits   | 2,952                    | 2,967                   |
| Short-term investments in money market funds  | 3,710                    | 6,811                   |
| Total cash and cash equivalents   | 23,482                   | 30,066                  |
| Investment securities:  |                          |                         |
| Available for sale  | 130,973                  | 141,978                 |
| Held to maturity (fair value \$19,626 on September 30, 2014 and \$17,788 on<br>December 31, 2013) | 19,498                   | 18,187                  |
| Loans held for sale   | 3,964                    | 3,402                   |
| Loans   | 814,477                  | 783,927                 |
| Less: Unearned income   | 554                      | 581                     |
| Allowance for loan losses   | 9,582                    | 10,104                  |
| Net loans   | 804,341                  | 773,242                 |
| Premises and equipment, net   | 13,409                   | 13,119                  |
| Accrued interest income receivable  | 3,280                    | 2,908                   |
| Goodwill  | 11,944                   | 12,613                  |
| Bank owned life insurance   | 37,228                   | 36,669                  |
| Net deferred tax asset  | 8,799                    | 9,572                   |
| Federal Home Loan Bank stock  | 5,027                    | 4,677                   |
| Federal Reserve Bank stock  | 2,125                    | 2,125                   |
| Other assets  | 6,361                    | 7,478                   |
| <b>TOTAL ASSETS</b>   | <b>\$1,070,431</b>       | <b>\$1,056,036</b>      |
| <b>LIABILITIES</b>  |                          |                         |
| Non-interest bearing deposits   | \$156,876                | \$154,002               |
| Interest bearing deposits   | 715,294                  | 700,520                 |
| Total deposits  | 872,170                  | 854,522                 |
| Short-term borrowings   | 26,438                   | 41,555                  |
| Advances from Federal Home Loan Bank  | 37,000                   | 25,000                  |
| Guaranteed junior subordinated deferrable interest debentures                                     | 13,085                   | 13,085                  |
| Total borrowed funds  | 76,523                   | 79,640                  |
| Other liabilities   | 5,592                    | 8,567                   |
| <b>TOTAL LIABILITIES</b>  | <b>954,285</b>           | <b>942,729</b>          |
| <b>SHAREHOLDERS EQUITY</b>  |                          |                         |

Edgar Filing: AMERISERV FINANCIAL INC /PA/ - Form 10-Q

|   |                    |                    |
|---|--------------------|--------------------|
| 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, 2014 and December 31, 2013                                      | 21,000             | 21,000             |
| Common stock, par value \$0.01 per share; 30,000,000 shares authorized; 26,412,707 shares issued and 18,794,888 outstanding on September 30, 2014; 26,402,007 shares issued and 18,784,188 outstanding on December 31, 2013 | 264                | 264                |
| Treasury stock at cost, 7,617,819 shares on September 30, 2014 and December 31, 2013  | (74,829 )          | (74,829 )          |
| Capital surplus   | 145,246            | 145,190            |
| Retained earnings   | 29,110             | 27,557             |
| Accumulated other comprehensive loss, net   | (4,645 )           | (5,875 )           |
| <b>TOTAL SHAREHOLDERS EQUITY</b>  | <b>116,146</b>     | <b>113,307</b>     |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>  | <b>\$1,070,431</b> | <b>\$1,056,036</b> |

See accompanying notes to unaudited consolidated financial statements.

TABLE OF CONTENTS**AmeriServ Financial, Inc.****CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share data)

(Unaudited)

|   | Three months<br>ended<br>September 30, |              | Nine months ended<br>September 30, |               |
|---|--|--------------|------------------------------------|---------------|
|   | 2014                                   | 2013         | 2014                               | 2013          |
| <b>INTEREST INCOME</b>  |  |              |                                    |               |
| Interest and fees on loans  | \$9,019                                | \$8,765      | \$26,990                           | \$25,983      |
| Interest bearing deposits   | 1                                      | 1            | 3                                  | 5             |
| Short-term investments in money market funds                            | 2                                      | 1            | 6                                  | 7             |
| Investment securities:  |  |              |                                    |               |
| Available for sale  | 859                                    | 911          | 2,688                              | 2,774         |
| Held to maturity  | 138                                    | 133          | 410                                | 371           |
| Total Interest Income   | 10,019                                 | 9,811        | 30,097                             | 29,140        |
| <b>INTEREST EXPENSE</b>   |  |              |                                    |               |
| Deposits  | 1,237                                  | 1,274        | 3,688                              | 3,912         |
| Short-term borrowings   | 10                                     | 12           | 34                                 | 25            |
| Advances from Federal Home Loan Bank                                    | 89                                     | 45           | 223                                | 100           |
| Guaranteed junior subordinated deferrable interest debentures           | 280                                    | 280          | 840                                | 840           |
| Total Interest Expense  | 1,616                                  | 1,611        | 4,785                              | 4,877         |
| <b>NET INTEREST INCOME</b>  | <b>8,403</b>                           | <b>8,200</b> | <b>25,312</b>                      | <b>24,263</b> |
| Provision (credit) for loan losses                                      |  |              |                                    | (100 )        |
| <b>NET INTEREST INCOME AFTER PROVISION (CREDIT)<br/>FOR LOAN LOSSES</b> | <b>8,403</b>                           | <b>8,200</b> | <b>25,312</b>                      | <b>24,363</b> |
| <b>NON-INTEREST INCOME</b>  |  |              |                                    |               |
| Trust and investment advisory fees                                      | 1,807                                  | 1,893        | 5,787                              | 5,773         |
| Service charges on deposit accounts                                     | 507                                    | 560          | 1,486                              | 1,609         |
| Net gains on sale of loans  | 275                                    | 285          | 547                                | 912           |
| Mortgage related fees   | 190                                    | 212          | 467                                | 641           |
| Net realized gains on investment securities                             |  | 66           | 177                                | 137           |
| Bank owned life insurance   | 188                                    | 204          | 559                                | 793           |
| Other income  | 626                                    | 766          | 1,740                              | 2,012         |
| Total Non-Interest Income   | 3,593                                  | 3,986        | 10,763                             | 11,877        |
| <b>NON-INTEREST EXPENSE</b>   |  |              |                                    |               |
| Salaries and employee benefits  | 6,139                                  | 6,251        | 18,560                             | 18,758        |
| Net occupancy expense   | 709                                    | 694          | 2,265                              | 2,218         |
| Equipment expense   | 468                                    | 429          | 1,432                              | 1,339         |
| Professional fees   | 1,360                                  | 1,034        | 4,132                              | 3,219         |
| Supplies, postage and freight   | 196                                    | 197          | 566                                | 619           |
| Miscellaneous taxes and insurance                                       | 276                                    | 360          | 884                                | 1,101         |
| Federal deposit insurance expense                                       | 159                                    | 152          | 473                                | 437           |
| Goodwill impairment charge  | 669                                    |              | 669                                |               |

Edgar Filing: AMERISERV FINANCIAL INC /PA/ - Form 10-Q

|                            |        |        |        |        |
|----------------------------|--------|--------|--------|--------|
| Other expense              | 1,267  | 1,296  | 3,620  | 3,786  |
| Total Non-Interest Expense | 11,243 | 10,413 | 32,601 | 31,477 |

See accompanying notes to unaudited consolidated financial statements.

2

---



TABLE OF CONTENTS**AmeriServ Financial, Inc.****CONSOLIDATED STATEMENTS OF OPERATIONS (continued)**

(In thousands, except per share data)

(Unaudited)

|   | Three months ended |         | Nine months ended |         |
|---|--------------------|---------|-------------------|---------|
|   | September 30,      |         | September 30,     |         |
|   | 2014               | 2013    | 2014              | 2013    |
| PRETAX INCOME                               | 753                | 1,773   | 3,474             | 4,763   |
| Provision for income tax expense            | 388                | 547     | 1,200             | 1,411   |
| NET INCOME                                  | 365                | 1,226   | 2,274             | 3,352   |
| Preferred stock dividends                   | 53                 | 53      | 158               | 157     |
| NET INCOME AVAILABLE TO COMMON SHAREHOLDERS | \$312              | \$1,173 | \$2,116           | \$3,195 |
| PER COMMON SHARE DATA:                      |                    |         |                   |         |
| Basic:                                      |                    |         |                   |         |
| Net income                                  | \$0.02             | \$0.06  | \$0.11            | \$0.17  |
| Average number of shares outstanding        | 18,795             | 18,784  | 18,792            | 18,995  |
| Diluted:                                    |                    |         |                   |         |
| Net income                                  | \$0.02             | \$0.06  | \$0.11            | \$0.17  |
| Average number of shares outstanding        | 18,908             | 18,878  | 18,916            | 19,086  |
| Cash dividends declared                     | \$0.01             | \$0.01  | \$0.03            | \$0.02  |

See accompanying notes to unaudited consolidated financial statements.

TABLE OF CONTENTS**AmeriServ Financial, Inc.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(In thousands)

(Unaudited)

|   | Three Months<br>Ended<br>September 30, |         | Nine months ended<br>September 30, |          |
|---|--|---------|------------------------------------|----------|
|   | 2014                                   | 2013    | 2014                               | 2013     |
| <b>COMPREHENSIVE INCOME</b>   |  |         |                                    |          |
| Net income  | \$365                                  | \$1,226 | \$2,274                            | \$3,352  |
| Other comprehensive income (loss), before tax:  |  |         |                                    |          |
| Pension obligation change for defined benefit plan  | 799                                    |         | 1,191                              | 823      |
| Income tax effect   | (272)                                  |         | (405 )                             | (280 )   |
| Unrealized holding gains (losses) on available for sale securities arising during period      | (701)                                  | 176     | 850                                | (3,429 ) |
| Income tax effect   | 238                                    | (60 )   | (289 )                             | 1,165    |
| Reclassification adjustment for gains on available for sale securities included in net income |  | (66 )   | (177 )                             | (137 )   |
| Income tax effect   |  | 23      | 60                                 | 47       |
| Other comprehensive income (loss)   | 64                                     | 73      | 1,230                              | (1,811 ) |
| Comprehensive income  | \$429                                  | \$1,299 | \$3,504                            | \$1,541  |

See accompanying notes to unaudited consolidated financial statements.

TABLE OF CONTENTS**AmeriServ Financial, Inc.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

|   | Nine months ended<br>September 30, |            |
|---|------------------------------------|------------|
|   | 2014                               | 2013       |
| <b>OPERATING ACTIVITIES</b>   |                                    |            |
| Net income  | \$2,274                            | \$ 3,352   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |            |
| Provision (credit) for loan losses  |                                    | (100 )     |
| Depreciation expense  | 1,359                              | 1,178      |
| Net amortization of investment securities   | 283                                | 629        |
| Net realized gains on investment securities available for sale                    | (177 )                             | (137 )     |
| Net gains on loans held for sale  | (547 )                             | (912 )     |
| Amortization of deferred loan fees  | (198 )                             | (228 )     |
| Origination of mortgage loans held for sale                                       | (36,105 )                          | (49,686 )  |
| Sales of mortgage loans held for sale   | 36,090                             | 58,340     |
| Increase in accrued interest income receivable                                    | (372 )                             | (340 )     |
| Decrease in accrued interest payable  | (173 )                             | (414 )     |
| Earnings on bank owned life insurance   | (559 )                             | (605 )     |
| Deferred income taxes   | 139                                | 1,327      |
| Stock based compensation expense  | 56                                 | 68         |
| Goodwill impairment charge  | 669                                |            |
| Decrease in prepaid Federal Deposit Insurance                                     |                                    | 1,444      |
| Other, net  | (679 )                             | (1,337 )   |
| Net cash provided by operating activities   | 2,060                              | 12,579     |
| <b>INVESTING ACTIVITIES</b>   |                                    |            |
| Purchases of investment securities - available for sale                           | (10,215 )                          | (41,176 )  |
| Purchases of investment securities - held to maturity                             | (2,442 )                           | (8,432 )   |
| Proceeds from sales of investment securities available for sale                   | 5,242                              | 2,298      |
| Proceeds from maturities of investment securities available for sale              | 16,581                             | 37,335     |
| Proceeds from maturities of investment securities held to maturity                | 1,095                              | 4,067      |
| Purchases of regulatory stock   | (6,679 )                           | (4,180 )   |
| Proceeds from redemption of regulatory stock                                      | 6,329                              | 3,844      |
| Long-term loans originated  | (126,805)                          | (144,733 ) |
| Principal collected on long-term loans  | 91,886                             | 111,399    |
| Loans purchased or participated   | (4,247 )                           | (9,000 )   |
| Loans sold or participated  | 7,810                              | 1,000      |
| Proceeds from sale of other real estate owned                                     | 454                                | 1,027      |
| Proceeds from life insurance policy   |                                    | 356        |
| Purchases of premises and equipment   | (1,643 )                           | (2,643 )   |
| Net cash used in investing activities   | (22,634 )                          | (48,838 )  |

See accompanying notes to unaudited consolidated financial statements.

TABLE OF CONTENTS**AmeriServ Financial, Inc.****CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)**

(In thousands)

(Unaudited)

|  | Nine months ended<br>September 30, |           |
|--|------------------------------------|-----------|
|  | 2014                               | 2013      |
| <b>FINANCING ACTIVITIES</b>                                  |                                    |           |
| Net increase in deposit balances                             | 17,828                             | 16,412    |
| Net (decrease) increase in other short-term borrowings       | (15,117 )                          | 15,436    |
| Principal borrowings on advances from Federal Home Loan Bank | 12,000                             | 14,000    |
| Principal repayments on advances from Federal Home Loan Bank |                                    | (6,000 )  |
| Purchases of treasury stock                                  |                                    | (1,171 )  |
| Common stock dividends                                       | (563 )                             | (379 )    |
| Preferred stock dividends                                    | (158 )                             | (157 )    |
| Net cash provided by financing activities                    | 13,990                             | 38,141    |
| NET (DECREASE) INCREASE IN CASH AND CASH<br>EQUIVALENTS      | (6,584 )                           | 1,882     |
| CASH AND CASH EQUIVALENTS AT JANUARY 1                       | 30,066                             | 26,820    |
| CASH AND CASH EQUIVALENTS AT SEPTEMBER 30                    | \$ 23,482                          | \$ 28,702 |

See accompanying notes to unaudited consolidated financial statements.

TABLE OF CONTENTS

# **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 17 locations in Pennsylvania. The Trust Company offers a complete range of trust and financial services and administers assets valued at \$1.8 billion that are not reported on the Company's balance sheet at September 30, 2014. 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 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, 2013.

## **3. Recent Accounting Pronouncements**

In July 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. This Update applies to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The amendments should be applied

prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. This ASU did not have a significant impact on the Company's financial statements.

In January 2014, the FASB issued ASU 2014-04, *Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. The amendments in this Update clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are

in

7

---

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****3. Recent Accounting Pronouncements (continued)**

the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this Update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in this Update using either a modified retrospective transition method or a prospective transition method. This ASU is not expected to have a significant impact on the Company's financial statements.

**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 to purchase 3,625 common shares, at exercise prices ranging from \$4.60 to \$5.22, and 101,070 common shares, at exercise prices ranging from \$3.23 to \$5.75, were outstanding as of September 30, 2014 and 2013, respectively, but were not included in the computation of diluted earnings per common share because to do so would be antidilutive. Dividends on preferred shares are deducted from net income in the calculation of earnings per common share.

|   | Three months ended<br>September 30,   |          | Nine months ended<br>September 30, |          |
|---|---------------------------------------|----------|------------------------------------|----------|
|   | 2014                                  | 2013     | 2014                               | 2013     |
|   | (In thousands, except per share data) |          |                                    |          |
| Numerator:  |                                       |          |                                    |          |
| Net income  | \$ 365                                | \$ 1,226 | \$ 2,274                           | \$ 3,352 |
| Preferred stock dividends                               | 53                                    | 53       | 158                                | 157      |
| Net income available to common shareholders             | \$ 312                                | \$ 1,173 | \$ 2,116                           | \$ 3,195 |
| Denominator:  |                                       |          |                                    |          |
| Weighted average common shares outstanding (basic)      | 18,795                                | 18,784   | 18,792                             | 18,995   |
| Effect of stock options                                 | 113                                   | 94       | 124                                | 91       |
| Weighted average common shares<br>outstanding (diluted) | 18,908                                | 18,878   | 18,916                             | 19,086   |
| Earnings per common share:                              |                                       |          |                                    |          |
| Basic   | \$ 0.02                               | \$ 0.06  | \$ 0.11                            | \$ 0.17  |
| Diluted   | 0.02                                  | 0.06     | 0.11                               | 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 \$1.1 million in income tax payments in the first nine months of 2014 as compared to \$86,000 for the first nine months of 2013. The Company made total interest payments of \$4,958,000 in the first nine months of 2014 compared to \$5,291,000 in the



same 2013 period. The Company had \$455,000 non-cash transfers to other real estate owned (OREO) in the first nine months of 2014 compared to \$593,000 in the same 2013 period.

8

---

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****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, 2014 |                        |                         |            |
|--------------------------------------|--------------------|------------------------|-------------------------|------------|
|                                      | Cost Basis         | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| US Agency                            | \$ 6,930           | \$ 33                  | \$ (58 )                | \$ 6,905   |
| US Agency mortgage-backed securities | 108,296            | 3,055                  | (666 )                  | 110,685    |
| Corporate bonds                      | 13,494             | 57                     | (168 )                  | 13,383     |
| Total                                | \$ 128,720         | \$ 3,145               | \$ (892 )               | \$ 130,973 |

**Investment securities held to maturity (HTM):**

|                                      | September 30, 2014 |                        |                         |            |
|--------------------------------------|--------------------|------------------------|-------------------------|------------|
|                                      | Cost Basis         | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| US Agency mortgage-backed securities | \$ 12,788          | \$ 340                 | \$ (169 )               | \$ 12,959  |
| Taxable municipal                    | 2,715              | 56                     | (54 )                   | 2,717      |
| Corporate bonds and other securities | 3,995              |                        | (45 )                   | 3,950      |
| Total                                | \$ 19,498          | \$ 396                 | \$ (268 )               | \$ 19,626  |

**Investment securities available for sale (AFS):**

|                                      | December 31, 2013 |                        |                         |            |
|--------------------------------------|-------------------|------------------------|-------------------------|------------|
|                                      | Cost Basis        | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| US Agency                            | \$ 6,926          | \$ 35                  | \$ (126 )               | \$ 6,835   |
| US Agency mortgage-backed securities | 121,480           | 3,129                  | (1,227 )                | 123,382    |
| Corporate bonds                      | 11,992            | 21                     | (252 )                  | 11,761     |
| Total                                | \$ 140,398        | \$ 3,185               | \$ (1,605 )             | \$ 141,978 |

**Investment securities held to maturity (HTM):**

|                                      | December 31, 2013 |                              |                               |               |
|--------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
|                                      | Cost<br>Basis     | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
| US Agency mortgage-backed securities | \$ 12,671         | \$ 289                       | \$ (477 )                     | \$ 12,483     |
| Taxable municipal                    | 1,521             |                              | (120 )                        | 1,401         |
| Corporate bonds and other securities | 3,995             |                              | (91 )                         | 3,904         |
| Total                                | \$ 18,187         | \$ 289                       | \$ (688 )                     | \$ 17,788     |

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, 2014, 86.4% of the portfolio was rated AAA as compared to 89.0% at December 31, 2013. 2.0% of the portfolio was either rated below A or unrated at September 30, 2014. The Company has no exposure to subprime mortgage loans in the investment portfolio. At September 30, 2014, the Company's consolidated investment securities portfolio had an effective duration of approximately 3.12 years.

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****6. Investment Securities (continued)**

Total proceeds from the sale of AFS securities for the first nine months of 2014 were \$5.2 million resulting in \$182,000 of gross investment security gains and \$5,000 of gross security losses. Total proceeds from the sale of AFS securities for the first nine months of 2013 were \$2.3 million resulting in \$137,000 of gross investment security gains. There were no sales of AFS securities in the third quarter of 2014. Sales of AFS securities in the third quarter of 2013 were \$1.1 million resulting in \$66,000 of gross investment security gains.

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 \$119,411,000 at September 30, 2014 and \$110,780,000 at December 31, 2013.

The following tables present information concerning investments with unrealized losses as of September 30, 2014 and December 31, 2013 (in thousands):

**Total investment securities:**

|                                      | September 30, 2014  |                   |                     |                   |            |                   |
|--------------------------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|                                      | Less than 12 months |                   | 12 months or longer |                   | Total      |                   |
|                                      | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| US Agency                            | \$50                | \$ (1 )           | \$3,843             | \$ (57 )          | \$3,893    | \$ (58 )          |
| US Agency mortgage-backed securities | 16,415              | (68 )             | 26,320              | (767 )            | 42,735     | (835 )            |
| Taxable municipal                    | 984                 | (11 )             | 968                 | (43 )             | 1,952      | (54 )             |
| Corporate bonds and other securities | 2,933               | (62 )             | 8,847               | (151 )            | 11,780     | (213 )            |
| Total                                | \$20,382            | \$ (142 )         | \$39,978            | \$ (1,018 )       | \$60,360   | \$ (1,160 )       |

**Total investment securities:**

|                                      | December 31, 2013   |                   |                     |                   |            |                   |
|--------------------------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|                                      | Less than 12 months |                   | 12 months or longer |                   | Total      |                   |
|                                      | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| US Agency                            | \$3,812             | \$ (64 )          | \$938               | \$ (62 )          | \$4,750    | \$ (126 )         |
| US Agency mortgage-backed securities | 52,163              | (1,701 )          | 669                 | (3 )              | 52,832     | (1,704 )          |
| Taxable municipal                    | 891                 | (120 )            |                     |                   | 891        | (120 )            |
| Corporate bonds and other securities | 9,687               | (300 )            | 2,957               | (43 )             | 12,644     | (343 )            |
| Total                                | \$66,553            | \$ (2,185 )       | \$4,564             | \$ (108 )         | \$71,117   | \$ (2,293 )       |

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 53 positions that are considered temporarily impaired at September 30, 2014. 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.

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****6. Investment Securities (continued)**

Contractual maturities of securities at September 30, 2014 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.

**Total investment securities:**

|                                    | September 30, 2014 |            |                  |            |
|------------------------------------|--------------------|------------|------------------|------------|
|                                    | Available for sale |            | Held to maturity |            |
|                                    | Cost Basis         | Fair Value | Cost Basis       | Fair Value |
| Within 1 year                      | \$ 1,000           | \$ 1,018   | \$ 2,000         | \$ 1,990   |
| After 1 year but within 5 years    | 13,827             | 13,944     | 1,000            | 979        |
| After 5 years but within 10 years  | 17,881             | 18,026     | 3,325            | 3,246      |
| After 10 years but within 15 years | 60,072             | 61,067     | 1,011            | 968        |
| Over 15 years                      | 35,940             | 36,918     | 12,162           | 12,443     |
| Total                              | \$ 128,720         | \$ 130,973 | \$ 19,498        | \$ 19,626  |

**7. Loans**

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

|   | September 30, 2014 | December 31, 2013 |
|---|--------------------|-------------------|
| Commercial                              | \$ 134,352         | \$ 120,102        |
| Commercial loans secured by real estate | 404,243            | 411,691           |
| Real estate-mortgage                    | 257,567            | 235,689           |
| Consumer                                | 17,761             | 15,864            |
| Loans, net of unearned income           | \$ 813,923         | \$ 783,346        |

Loan balances at September 30, 2014 and December 31, 2013 are net of unearned income of \$554,000 and \$581,000, respectively. Real estate-construction loans comprised 3.5% and 3.0% of total loans, net of unearned income at September 30, 2014 and December 31, 2013, respectively.

**8. Allowance for Loan Losses**

The following tables summarize the rollforward of the allowance for loan losses by portfolio segment for the three and

nine month periods ending September 30, 2014 and 2013 (in thousands).

|   | Three months ended September 30, 2014 |             |            |           | Balance at |
|---|---------------------------------------|-------------|------------|-----------|------------|
|   | Balance                               | Charge-Offs | Recoveries | Provision | September  |
|   | at                                    |             |            | (Credit)  | 30,        |
|   | June 30,                              |             |            |           | 2014       |
|   | 2014                                  |             |            |           | 2014       |
| Commercial                              | \$3,254                               | \$          | \$ 6       | \$ 35     | \$ 3,295   |
| Commercial loans secured by real estate | 4,475                                 | (506 )      | 24         | (78 )     | 3,915      |
| Real estate-mortgage                    | 1,301                                 | (103 )      | 29         | 115       | 1,342      |
| Consumer                                | 145                                   | (24 )       | 6          | 24        | 151        |
| Allocation for general risk             | 975                                   |             |            | (96 )     | 879        |
| Total                                   | \$10,150                              | \$ (633 )   | \$ 65      | \$        | \$ 9,582   |

11

---

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****8. Allowance for Loan Losses (continued)**

|   | Three months ended September 30, 2013 |             |            |           | Balance at |
|---|---------------------------------------|-------------|------------|-----------|------------|
|   | Balance                               |             |            | Provision | September  |
|   | at                                    | Charge-Offs | Recoveries | (Credit)  | 30,        |
|   | June 30,                              |             |            |           | 2013       |
|   | 2013                                  |             |            |           | 2013       |
| Commercial                              | \$ 2,780                              | \$          | \$ 17      | \$ 891    | \$ 3,688   |
| Commercial loans secured by real estate | 5,983                                 |             | 39         | (993 )    | 5,029      |
| Real estate-mortgage                    | 1,279                                 | (49 )       | 31         | 62        | 1,323      |
| Consumer                                | 146                                   | (8 )        | 8          | (6 )      | 140        |
| Allocation for general risk             | 957                                   |             |            | 46        | 1,003      |
| Total                                   | \$ 11,145                             | \$ (57 )    | \$ 95      | \$        | \$ 11,183  |

|   | Nine months ended September 30, 2014 |             |            |           | Balance at |
|---|--------------------------------------|-------------|------------|-----------|------------|
|   | Balance                              |             |            | Provision | September  |
|   | at                                   | Charge-Offs | Recoveries | (Credit)  | 30,        |
|   | December                             |             |            |           | 30,        |
|   | 31,                                  |             |            |           | 2014       |
|   | 2013                                 |             |            |           |            |
| Commercial                              | \$ 2,844                             | \$ (72 )    | \$ 111     | \$ 412    | \$ 3,295   |
| Commercial loans secured by real estate | 4,885                                | (572 )      | 196        | (594 )    | 3,915      |
| Real estate-mortgage                    | 1,260                                | (176 )      | 54         | 204       | 1,342      |
| Consumer                                | 136                                  | (82 )       | 19         | 78        | 151        |
| Allocation for general risk             | 979                                  |             |            | (100 )    | 879        |
| Total                                   | \$ 10,104                            | \$ (902 )   | \$ 380     | \$        | \$ 9,582   |

|   | Nine months ended September 30, 2013 |             |            |           | Balance at |
|---|--------------------------------------|-------------|------------|-----------|------------|
|   | Balance                              |             |            | Provision | September  |
|   | at                                   | Charge-Offs | Recoveries | (Credit)  | 30,        |
|   | December                             |             |            |           | 30,        |
|   | 31,                                  |             |            |           | 2013       |
|   | 2012                                 |             |            |           |            |
| Commercial                              | \$ 2,596                             | \$          | \$ 48      | \$ 1,044  | \$ 3,688   |
| Commercial loans secured by real estate | 7,796                                | (1,480 )    | 181        | (1,468 )  | 5,029      |
| Real estate-mortgage                    | 1,269                                | (96 )       | 98         | 52        | 1,323      |
| Consumer                                | 150                                  | (87 )       | 48         | 29        | 140        |
| Allocation for general risk             | 760                                  |             |            | 243       | 1,003      |
| Total                                   | \$ 12,571                            | \$ (1,663 ) | \$ 375     | \$ (100 ) | \$ 11,183  |



As a result of successful ongoing problem credit resolution efforts, the Company achieved further asset quality improvements in 2014 and 2013, specifically in the commercial loans secured by real estate category, which resulted in no provision in 2014 and a credit provision in 2013.

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****8. Allowance for Loan Losses (continued)**

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, 2014                               |                             |           |                                      |           |          |
|---------------------------------------|---|-----------------------------|-----------|--------------------------------------|-----------|----------|
|                                       | Commercial<br>Loans<br>Secured<br>by Real<br>Estate | Real<br>Estate-<br>Mortgage | Consumer  | Allocation<br>for<br>General<br>Risk | Total     |          |
| Loans:                                |   |                             |           |                                      |           |          |
| Individually evaluated for impairment | \$ 1,444  | \$                          | \$        |                                      | \$1,444   |          |
| Collectively evaluated for impairment | 134,352   | 402,799                     | 257,567   | 17,761                               | 812,479   |          |
| Total loans                           | \$134,352   | \$404,243                   | \$257,567 | \$17,761                             | \$813,923 |          |
| Allowance for loan losses:            |   |                             |           |                                      |           |          |
| Specific reserve allocation           | \$ 547  | \$                          | \$        | \$                                   | \$547     |          |
| General reserve allocation            | 3,295   | 3,368                       | 1,342     | 151                                  | 879       | 9,035    |
| Total allowance for loan losses       | \$3,295   | \$3,915                     | \$1,342   | \$151                                | \$879     | \$9,582  |
|                                       | At December 31, 2013                                |                             |           |                                      |           |          |
|                                       | Commercial<br>Loans<br>Secured<br>by Real<br>Estate | Real<br>Estate-<br>Mortgage | Consumer  | Allocation<br>for<br>General<br>Risk | Total     |          |
| Loans:                                |   |                             |           |                                      |           |          |
| Individually evaluated for impairment | \$ 3,005  | \$                          | \$61      |                                      | \$3,066   |          |
| Collectively evaluated for impairment | 120,102   | 408,686                     | 235,689   | 15,803                               | 780,280   |          |
| Total loans                           | \$120,102   | \$411,691                   | \$235,689 | \$15,864                             | \$783,346 |          |
| Allowance for loan losses:            |   |                             |           |                                      |           |          |
| Specific reserve allocation           | \$ 812  | \$                          | \$1       | \$                                   | \$813     |          |
| General reserve allocation            | 2,844   | 4,073                       | 1,260     | 135                                  | 979       | 9,291    |
| Total allowance for loan losses       | \$2,844   | \$4,885                     | \$1,260   | \$136                                | \$979     | \$10,104 |

The segments of the Company's loan portfolio are disaggregated to a level that allows management to monitor risk and performance. The loan segments 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 and therefore, no further disaggregation into classes is necessary. The overall risk profile for the commercial loan segment is impacted by non-owner occupied CRE loans, which include loans secured by non-owner occupied nonfarm nonresidential properties, as a meaningful but declining portion 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 or commercial real estate 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

TABLE OF CONTENTS

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**8. Allowance for Loan Losses (continued)**

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 dependent 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.

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.

14

---

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****8. Allowance for Loan Losses (continued)**

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, 2014                     |                   |   |                      |                          |
|---|--|-------------------|---|----------------------|--------------------------|
|   | Impaired Loans with Specific Allowance |                   | Impaired Loans with no Specific Allowance | Total Impaired Loans | Unpaid Principal Balance |
|   | Recorded Investment                    | Related Allowance | Recorded Investment                       | Recorded Investment  |                          |
| Commercial loans secured by real estate | \$ 1,064                               | \$ 547            | \$ 380                                    | \$ 1,444             | \$ 1,981                 |
| Total impaired loans                    | \$ 1,064                               | \$ 547            | \$ 380                                    | \$ 1,444             | \$ 1,981                 |

|   | December 31, 2013                      |                   |   |                      |                          |
|---|--|-------------------|---|----------------------|--------------------------|
|   | Impaired Loans with Specific Allowance |                   | Impaired Loans with no Specific Allowance | Total Impaired Loans | Unpaid Principal Balance |
|   | Recorded Investment                    | Related Allowance | Recorded Investment                       | Recorded Investment  |                          |
| Commercial loans secured by real estate | \$ 3,005                               | \$ 812            | \$  | \$ 3,005             | \$ 3,118                 |
| Consumer                                | 61                                     | 1                 |   | 61                   | 61                       |
| Total impaired loans                    | \$ 3,066                               | \$ 813            | \$  | \$ 3,066             | \$ 3,179                 |

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, |          |
|---|----------------------------------|----------|---------------------------------|----------|
|   | 2014                             | 2013     | 2014                            | 2013     |
| Average loan balance:                   |                                  |          |                                 |          |
| Commercial                              | \$                               | \$ 50    | \$                              | \$ 6     |
| Commercial loans secured by real estate | 1,897                            | 2,170    | 2,012                           | 2,904    |
| Consumer                                |                                  | 63       |                                 | 18       |
| Average investment in impaired loans    | \$ 1,897                         | \$ 2,283 | \$ 2,012                        | \$ 2,928 |
| Interest income recognized:             |                                  |          |                                 |          |

|  |      |      |      |      |
|--|------|------|------|------|
| Commercial loans secured by real estate                      | \$ 4 | \$ 3 | \$ 6 | \$ 7 |
| Consumer   |      |      |      | 1    |
| Interest income recognized on a cash basis on impaired loans | \$ 4 | \$ 3 | \$ 6 | \$ 8 |

Management uses a nine 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. Loans in the Doubtful category have all the weaknesses inherent in a credit classified Substandard with weaknesses pronounced to a point where collection or liquidation in full, on the basis of current facts, conditions, and value is highly

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****8. Allowance for Loan Losses (continued)**

questionable, but the extent of loss is not currently determinable. 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's 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 2014 required review of a minimum range of 50% to 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. Additionally, the Asset Quality Task Force, which is a group comprised of senior level personnel, meets monthly to monitor the status of problem loans.

The following table presents the classes of the commercial loan portfolios 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, 2014 |                    |             |          |            |
|---|--------------------|--------------------|-------------|----------|------------|
|   | Pass               | Special<br>Mention | Substandard | Doubtful | Total      |
| Commercial                              | \$ 128,253         | \$ 100             | \$ 5,861    | \$ 138   | \$ 134,352 |
| Commercial loans secured by real estate | 399,334            | 627                | 3,995       | 287      | 404,243    |
| Total                                   | \$ 527,587         | \$ 727             | \$ 9,856    | \$ 425   | \$ 538,595 |
|   | December 31, 2013  |                    |             |          |            |
|   | Pass               | Special<br>Mention | Substandard | Doubtful | Total      |
| Commercial                              | \$ 108,623         | \$ 8,880           | \$ 2,599    | \$       | \$ 120,102 |



Edgar Filing: AMERISERV FINANCIAL INC /PA/ - Form 10-Q

|   |            |           |           |        |            |
|---|------------|-----------|-----------|--------|------------|
| Commercial loans secured by real estate | 396,788    | 6,961     | 7,482     | 460    | 411,691    |
| Total                                   | \$ 505,411 | \$ 15,841 | \$ 10,081 | \$ 460 | \$ 531,793 |

16

---

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****8. Allowance for Loan Losses (continued)**

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, 2014 |                |
|----------------------|--------------------|----------------|
|                      | Performing         | Non-Performing |
| Real estate-mortgage | \$ 255,796         | \$ 1,771       |
| Consumer             | 17,761             |                |
| Total                | \$ 273,557         | \$ 1,771       |

|                      | December 31, 2013 |                |
|----------------------|-------------------|----------------|
|                      | Performing        | Non-Performing |
| Real estate-mortgage | \$ 234,450        | \$ 1,239       |
| Consumer             | 15,803            | 61             |
| Total                | \$ 250,253        | \$ 1,300       |

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, 2014 |                  |                  |                  |                  |                  | 90 Days Past Due and Still Accruing |
|---|--------------------|------------------|------------------|------------------|------------------|------------------|-------------------------------------|
|   | Current            | 30 Days Past Due | 59 Days Past Due | 60 Days Past Due | 89 Days Past Due | 90 Days Past Due | Total Past Due                      |
| Commercial                              | \$ 134,287         | \$ 65            | \$               | \$               | \$ 65            | \$ 134,352       | \$                                  |
| Commercial loans secured by real estate | 403,561            | 250              |                  |                  | 432              | 404,243          |                                     |
| Real estate-mortgage                    | 254,076            | 1,605            | 422              |                  | 1,464            | 257,567          |                                     |
| Consumer                                | 17,672             | 67               | 22               |                  | 89               | 17,761           |                                     |
| Total                                   | \$ 809,596         | \$ 1,987         | \$ 444           | \$ 1,896         | \$ 4,327         | \$ 813,923       | \$                                  |

December 31, 2013

|   | Current   | 30<br>Days<br>Past<br>Due | 59<br>Days<br>Past<br>Due | 60<br>Days<br>Past<br>Due | 89<br>Days<br>Past<br>Due | 90 Days<br>Past<br>Due | Total<br>Past<br>Due | Total<br>Loans | 90<br>Days<br>Past<br>Due<br>and<br>Still<br>Accruing |
|---|-----------|---------------------------|---------------------------|---------------------------|---------------------------|------------------------|----------------------|----------------|---|
| Commercial                              | \$120,102 | \$                        | \$                        | \$                        | \$                        | \$                     | \$                   | \$120,102      | \$  |
| Commercial loans secured by real estate | 410,619   | 457                       |                           |                           |                           | 615                    | 1,072                | 411,691        |   |
| Real estate-mortgage                    | 231,740   | 2,232                     | 670                       |                           | 1,047                     | 3,949                  | 235,689              |                |   |
| Consumer                                | 15,804    | 33                        | 27                        |                           |                           | 60                     | 15,864               |                |   |
| Total                                   | \$778,265 | \$2,722                   | \$697                     | \$1,662                   | \$5,081                   | \$783,346              | \$                   |                |   |

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.

TABLE OF CONTENTS

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**8. Allowance for Loan Losses (continued)**

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 ALL.

**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 December  
30, 31,

|  | 2014     | 2013     |
|--|----------|----------|
| <u>Non-accrual loans</u>   |          |          |
| Commercial loans secured by real estate  | \$ 1,230 | \$ 1,632 |
| Real estate-mortgage   | 1,771    | 1,239    |
| Total  | 3,001    | 2,871    |
| <u>Other real estate owned</u>   |          |          |
| Commercial loans secured by real estate  | 592      | 344      |
| Real estate-mortgage   | 91       | 673      |
| Total  | 683      | 1,017    |
| TDR s not in non-accrual   | 214      | 221      |
| Total non-performing assets including TDR  | \$3,898  | \$4,109  |
| Total non-performing assets as a percent of loans, net of unearned income, and other real estate owned | 0.48 %   | 0.52 %   |

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****9. Non-performing Assets Including Troubled Debt Restructurings (TDR) (continued)**

The Company had no loans past due 90 days or more for the periods presented which were accruing interest.

The following table sets forth, for the periods indicated, (1) the gross interest income that would have been recorded if non-accrual loans had been current in accordance with their original terms and had been outstanding throughout the period or since origination if held for part of the period, (2) the amount of interest income actually recorded on such loans, and (3) the net reduction in interest income attributable to such loans (in thousands).

|   | Three months ended September 30, |       | Nine months ended September 30, |        |
|---|----------------------------------|-------|---------------------------------|--------|
|   | 2014                             | 2013  | 2014                            | 2013   |
| Interest income due in accordance with original terms | \$ 39                            | \$ 37 | \$ 106                          | \$ 139 |
| Interest income recorded                              |                                  |       |                                 |        |
| Net reduction in interest income                      | \$ 39                            | \$ 37 | \$ 106                          | \$ 139 |

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);  
the borrower has filed for bankruptcy;  
the borrower has insufficient cash flows to service their loan(s); and  
the borrower is unable to obtain refinancing from other sources at a market rate similar to rates available to a non-troubled debtor.

Factors that indicate that a concession has been granted include, but are not limited to:

the borrower is granted an interest rate reduction to a level below market rates for debt with similar risk; or  
the borrower is granted a material maturity date extension, or extension of the amortization plan to provide payment relief. For purposes of this policy, a material maturity date extension will generally include any maturity date extension, or the aggregate of multiple consecutive maturity date extensions, that exceed 120 days. A restructuring that results in an insignificant delay in payment, i.e. 120 days or less, is not necessarily a TDR. Insignificant payment

delays occur when the amount of the restructured payments subject to the delay is insignificant relative to the unpaid principal or collateral value, and will result in an insignificant shortfall in the originally scheduled contractual amount due, and/or the delay in timing of the restructured payment period is insignificant relative to the frequency of payments, the original maturity or the original amortization.

The determination of whether a restructured loan is a TDR requires consideration of all of the facts and circumstances surrounding the modification. No single factor is determinative of whether a restructuring is a TDR. An overall general decline in the economy or some deterioration in a borrower's financial condition does not automatically mean that the borrower is experiencing financial difficulty. Accordingly, determination of whether a modification is a TDR involves a large degree of judgment.

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****9. Non-performing Assets Including Troubled Debt Restructurings (TDR) (continued)**

The Company had no loans modified as TDRs during the three month period ended September 30, 2014.

The following table details the loans modified as TDRs during the nine month period ended September 30, 2014 (dollars in thousands).

| Loans in non-accrual status            | # of Loans | Current Balance | Concession Granted         |
|--|------------|-----------------|----------------------------|
| Commercial loan secured by real estate | 1          | \$ 138          | Extension of maturity date |

The following table details the loans modified as TDRs during the three and nine month periods ended on September 30, 2013.

| Loans in accrual status | # of Loans | Current Balance | Concession Granted         |
|-------------------------|------------|-----------------|----------------------------|
| Consumer                | 1          | \$ 51           | Extension of maturity date |

In all instances where loans have been modified in troubled debt restructurings the pre- and post-modified balances are the same. The specific ALL reserve for loans modified as TDR s was \$503,000 and \$372,000 as of September 30, 2014 and 2013, respectively.

Once a loan is classified as a TDR, this classification will remain until documented improvement in the financial position of the borrower supports confidence that all principal and interest will be paid according to terms. Additionally, the customer must have re-established a track record of timely payments according to the restructured contract terms for a minimum of six consecutive months prior to consideration for removing the loan from non-accrual TDR status. However, a loan will continue to be on non-accrual status until, consistent with our policy, the borrower has made a minimum of an additional six consecutive monthly payments in accordance with the terms of the loan.

The following table presents the recorded investment in loans that were modified as TDR s during each 12-month period prior to the current reporting periods, which begin January 1, 2014 and 2013 (nine month periods) and July 1, 2014 and 2013 (3 month periods), respectively, and that subsequently defaulted during these reporting periods (dollars in thousands).

|  | Three months ended<br>September 30, |      | Nine months ended<br>September 30, |          |
|--|-------------------------------------|------|------------------------------------|----------|
|  | 2014                                | 2013 | 2014                               | 2013     |
| <u>Recorded investment of defaults</u> |                                     |      |                                    |          |
| Commercial loan secured by real estate | \$                                  | \$   | \$                                 | \$ 1,320 |



Total \$ \$ \$ \$ 1,320

All TDR s are individually evaluated for impairment and a related allowance is recorded, as needed. All TDR s which defaulted in the above table had a related allowance adequate to reserve for anticipated losses.

The Company is unaware of any additional loans which are required to either be charged-off or added to the non-performing asset totals disclosed above.

20

---

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****10. Federal Home Loan Bank Borrowings**

Total Federal Home Loan Bank (FHLB) borrowings and advances consist of the following (in thousands, except percentages):

| Type                       | At September 30, 2014 |           | Weighted<br>Average Rate |
|----------------------------|-----------------------|-----------|--------------------------|
|                            | Maturing              | Amount    |                          |
| Open Repo Plus<br>Advances | Overnight             | \$ 26,438 | 0.26 %                   |
|                            | 2015                  | 4,000     | 0.52                     |
|                            | 2016                  | 12,000    | 0.81                     |
|                            | 2017                  | 12,000    | 1.06                     |
|                            | 2018                  | 9,000     | 1.54                     |
| Total advances             |                       | 37,000    | 1.04                     |
| Total FHLB borrowings      |                       | \$ 63,438 | 0.71 %                   |

| Type                       | At December 31, 2013 |           | Weighted<br>Average Rate |
|----------------------------|----------------------|-----------|--------------------------|
|                            | Maturing             | Amount    |                          |
| Open Repo Plus<br>Advances | Overnight            | \$ 41,555 | 0.25 %                   |
|                            | 2015                 | 4,000     | 0.52                     |
|                            | 2016                 | 12,000    | 0.81                     |
|                            | 2017                 | 7,000     | 1.07                     |
|                            | 2018                 | 2,000     | 1.47                     |
| Total advances             |                      | 25,000    | 0.89                     |
| Total FHLB borrowings      |                      | \$ 66,555 | 0.49 %                   |

The rate on Open Repo Plus advances can change daily, while the rates on the advances are fixed until the maturity of the advance.

**11. Preferred Stock**

On August 11, 2011, pursuant to the Small Business Lending Fund (SBLF), the Company issued and sold to the US Treasury 21,000 shares of its Senior Non-Cumulative Perpetual Preferred Stock, Series E (Series E Preferred Stock) for the aggregate proceeds of \$21 million. The SBLF is a voluntary program sponsored by the US Treasury that encourages small business lending by providing capital to qualified community banks at favorable rates. The initial interest rate on the Series E Preferred Stock has been initially set at 5% per annum and may be decreased to as low as 1% per annum if growth thresholds are met for qualified outstanding small business loans. The Company used the proceeds from the Series E Preferred Stock issued to the US Treasury to repurchase all 21,000 shares of its outstanding preferred shares previously issued to the US Treasury under the TARP Capital Purchase Program.

The Series E Preferred Stock has an aggregate liquidation preference of approximately \$21 million and qualifies as Tier 1 Capital for regulatory purposes. The terms of the Series E Preferred Stock provide for the payment of non-cumulative dividends on a quarterly basis. The dividend rate, as a percentage of the liquidation amount, may fluctuate while the Series E Preferred Stock is outstanding based upon changes in the level of qualified small business lending ( QSBL ) by the Bank from its average level of QSBL at each of the four quarter ends leading up to September 30, 2010 (the Baseline ) as follows:

| DIVIDEND PERIOD | ANNUALIZED BEGINNING | ANNUALIZED ENDING | ANNUALIZED DIVIDEND RATE    |
|-----------------|----------------------|-------------------|-----------------------------|
|                 | August 11, 2011      | December 31, 2011 | 5.0%                        |
|                 | January 1, 2012      | December 31, 2013 | 1.0% to 5.0%                |
|                 | January 1, 2014      | February 7, 2016  | 1.0% to 7.0% <sup>(1)</sup> |
|                 | February 8, 2016     | Redemption        | 9.0% <sup>(2)</sup>         |

21

---

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****11. Preferred Stock (continued)**

(1) Between January 1, 2014 and February 7, 2016, the Company's dividend rate was fixed at 1% based upon the level of percentage change in QSBL between September 30, 2013 and the Baseline.

(2) Beginning on February 8, 2016, the dividend rate will be fixed at nine percent (9%) per annum. As of September 30, 2013, the Company had increased its QSBL to a level that reduced the dividend rate to 1%. Accordingly, this 1% rate will continue through February 7, 2016.

As long as shares of Series E Preferred Stock remain outstanding, we may not pay dividends to our common shareholders (nor may we repurchase or redeem any shares of our common stock) during any quarter in which we fail to declare and pay dividends on the Series E Preferred Stock and for the next three quarters following such failure. In addition, under the terms of the Series E Preferred Stock, we may only declare and pay dividends on our common stock (or repurchase shares of our common stock), if, after payment of such dividend, the dollar amount of our Tier 1 capital would be at least ninety percent (90%) of Tier 1 capital as of September 30, 2011, excluding any charge-offs and redemptions of the Series E Preferred Stock (the Tier 1 Dividend Threshold). The Tier 1 Dividend Threshold is subject to reduction, beginning January 1, 2014, based upon the extent by which, if at all, the QSBL at September 30, 2013 has increased over the Baseline.

We may redeem the Series E Preferred Stock at any time at our option, at a redemption price of 100% of the liquidation amount plus accrued but unpaid dividends, subject to the approval of our federal banking regulator.

**12. Accumulated Other Comprehensive Loss**

The following table presents the changes in each component of accumulated other comprehensive loss, net of tax, for the three months ended September 30, 2014 and 2013 (in thousands):

|   | Three months ended<br>September 30, 2014                                       |   |                      | Three months ended<br>September 30, 2013                                       |   |                      |
|---|--|---|----------------------|--|---|----------------------|
|   | Net<br>Unrealized  |   |                      | Net<br>Unrealized  |   |                      |
|   | Gains<br>and<br>Losses<br>on<br>Investment<br>Securities<br>AFS <sup>(1)</sup> | Defined<br>Benefit<br>Pension<br>Items <sup>(1)</sup> | Total <sup>(1)</sup> | Gains<br>and<br>Losses<br>on<br>Investment<br>Securities<br>AFS <sup>(1)</sup> | Defined<br>Benefit<br>Pension<br>Items <sup>(1)</sup> | Total <sup>(1)</sup> |
| Beginning balance   | \$1,950  | \$(6,659)   | \$(4,709)            | \$1,714  | \$(8,977)   | \$(7,263)            |
| Other comprehensive income (loss)<br>before reclassifications | (463 )   |   | (463 )               | 116  |   | 116                  |

|  |         |           |           |         |           |           |
|--|---------|-----------|-----------|---------|-----------|-----------|
| Amounts reclassified from accumulated other comprehensive loss |         | 527       | 527       | (43 )   |           | (43 )     |
| Net current period other comprehensive income (loss)           | (463 )  | 527       | 64        | 73      |           | 73        |
| Ending balance   | \$1,487 | \$(6,132) | \$(4,645) | \$1,787 | \$(8,977) | \$(7,190) |

(1) Amounts in parentheses indicate debits on the Consolidated Balance Sheets.

22

---

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****12. Accumulated Other Comprehensive Loss (continued)**

The following table presents the changes in each component of accumulated other comprehensive loss, net of tax, for the nine months ended September 30, 2014 and 2013 (in thousands):

|  | Nine months ended September 30, 2014  |  |                      | Nine months ended September 30, 2013  |  |                      |
|--|---|--|----------------------|---|--|----------------------|
|  | Net Unrealized Gains and Losses on Investment Securities AFS <sup>(1)</sup> | Defined Benefit Pension Items <sup>(1)</sup> | Total <sup>(1)</sup> | Net Unrealized Gains and Losses on Investment Securities AFS <sup>(1)</sup> | Defined Benefit Pension Items <sup>(1)</sup> | Total <sup>(1)</sup> |
| Beginning balance  | \$1,043   | \$(6,918)                                    | \$(5,875)            | \$4,141   | \$(9,520)                                    | \$(5,379)            |
| Other comprehensive income (loss) before reclassifications     | 561   | 259  | 820                  | (2,264)   | 103  | (2,161)              |
| Amounts reclassified from accumulated other comprehensive loss | (117 )  | 527  | 410                  | (90 )   | 440  | 350                  |
| Net current period other comprehensive income (loss)           | 444   | 786  | 1,230                | (2,354)   | 543  | (1,811)              |
| Ending balance   | \$1,487   | \$(6,132)                                    | \$(4,645)            | \$1,787   | \$(8,977)                                    | \$(7,190)            |

(1) Amounts in parentheses indicate debits on the Consolidated Balance Sheets.

The following table presents the amounts reclassified out of each component of accumulated other comprehensive loss for the three months ended September 30, 2014 and 2013 (in thousands):

| Details about accumulated other comprehensive loss components | Amount reclassified from accumulated other comprehensive loss <sup>(1)</sup> |   | Affected line item in the statement of operations |
|---|--|---|---|
|   | For the three months ended September 30, 2014                                | For the three months ended September 30, 2013 |   |
| Unrealized gains and losses on sale of securities             |  |   |   |

|  |        |          |   |
|--|--------|----------|---|
|  | \$     | \$ (66 ) | Net realized gains on investment securities |
|  |        | 23       | Provision for income tax expense            |
| Amortization of defined benefit items <sup>(2)</sup> | \$     | \$ (43 ) | Net of tax                                  |
| Recognized net actuarial loss                        | \$ 813 | \$       | Salaries and employee benefits              |
| Prior service cost                                   | (14 )  |          | Salaries and employee benefits              |
|  | 799    |          | Pretax income                               |
|  | (272 ) |          | Provision for income tax expense            |
|  | \$ 527 | \$       | Net income                                  |
| Total reclassifications for the period               | \$ 527 | \$ (43 ) | Net income                                  |

(1) Amounts in parentheses indicate credits.

(2) These accumulated other comprehensive loss components are included in the computation of net periodic benefit cost (see Note 16 for additional details).

23

---

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****12. Accumulated Other Comprehensive Loss (continued)**

The following table presents the amounts reclassified out of each component of accumulated other comprehensive loss for the nine months ended September 30, 2014 and 2013 (in thousands):

| Details about accumulated other comprehensive loss components | Amount reclassified from accumulated other comprehensive loss <sup>(1)</sup> |  | Affected line item in the statement of operations |
|---|--|--|---|
|   | For the nine months ended September 30, 2014                                 | For the nine months ended September 30, 2013 |   |
| Unrealized gains and losses on sale of securities             |  |  | Net realized gains on investment securities       |
|   | \$ (177)   | \$ (137)                                     |   |
|   | 60   | 47   | Provision for income tax expense                  |
|   | \$ (117)   | \$ (90)                                      | Net of tax  |
| Amortization of defined benefit items <sup>(2)</sup>          |  |  |   |
| Recognized net actuarial loss                                 | \$ 813   | \$ 682                                       | Salaries and employee benefits                    |
| Prior service cost  | (14 )  | (10 )  | Salaries and employee benefits                    |
| Transition asset  |  | (4 )   | Salaries and employee benefits                    |
|   | 799  | 668  | Pretax income                                     |
|   | (272)  | (228)  | Provision for income tax expense                  |
|   | \$ 527   | \$ 440                                       | Net income  |
| Total reclassifications for the period                        | \$ 410   | \$ 350                                       | Net income  |

(1) Amounts in parentheses indicate credits.

(2) These accumulated other comprehensive loss components are included in the computation of net periodic benefit cost (see Note 16 for additional details).



## 13. Regulatory Capital

The Company is subject to various capital requirements administered by the federal banking agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements.

24

---

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****13. Regulatory Capital (continued)**

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. As of September 30, 2014, the Federal Reserve categorized the Company as Well Capitalized under the regulatory framework for prompt corrective action. The Company believes that no conditions or events have occurred that would change this conclusion. To be categorized as Well Capitalized, the Company must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. Additionally, while not a regulatory capital ratio, the Company's tangible common equity ratio was 7.86% at September 30, 2014 (in thousands, except ratios).

|   | At September 30, 2014 |        |                               |       |  |        |
|---|-----------------------|--------|-------------------------------|-------|--|--------|
|   | Actual                |        | For Capital Adequacy Purposes |       | To Be Well Capitalized Under Prompt Corrective Action Provisions |        |
|   | Amount                | Ratio  | Amount                        | Ratio | Amount   | Ratio  |
| Total Capital (To Risk Weighted Assets) Consolidated  | \$ 130,416            | 15.00% | \$ 69,571                     | 8.00% | \$ 86,964  | 10.00% |
| AmeriServ Financial Bank                              | 106,597               | 12.39  | 68,822                        | 8.00  | 86,027   | 10.00  |
| Tier 1 Capital (To Risk Weighted Assets) Consolidated | 120,042               | 13.80  | 34,786                        | 4.00  | 52,178   | 6.00   |
| AmeriServ Financial Bank                              | 96,223                | 11.19  | 34,411                        | 4.00  | 51,616   | 6.00   |
| Tier 1 Capital (To Average Assets) Consolidated       | 120,042               | 11.44  | 41,977                        | 4.00  | 52,471   | 5.00   |
| AmeriServ Financial Bank                              | 96,223                | 9.41   | 40,921                        | 4.00  | 51,151   | 5.00   |
|   | At December 31, 2013  |        |                               |       |  |        |
|   | Actual                |        | For Capital Adequacy Purposes |       | To Be Well Capitalized Under Prompt Corrective Action Provisions |        |
|   | Amount                | Ratio  | Amount                        | Ratio | Amount   | Ratio  |
| Total Capital (To Risk Weighted Assets) Consolidated  | \$ 128,469            | 15.28% | \$ 67,247                     | 8.00% | \$ 84,059  | 10.00% |
| AmeriServ Financial Bank                              | 103,009               | 12.39  | 66,506                        | 8.00  | 83,132   | 10.00  |
| Tier 1 Capital (To Risk Weighted Assets) Consolidated | 117,957               | 14.03  | 33,624                        | 4.00  | 50,435   | 6.00   |
| AmeriServ Financial Bank                              | 92,611                | 11.14  | 33,253                        | 4.00  | 49,879   | 6.00   |

|                                    |         |       |        |      |        |      |
|------------------------------------|---------|-------|--------|------|--------|------|
| Tier 1 Capital (To Average Assets) |         |       |        |      |        |      |
| Consolidated                       | 117,957 | 11.45 | 41,204 | 4.00 | 51,505 | 5.00 |
| AmeriServ Financial Bank           | 92,611  | 9.23  | 40,124 | 4.00 | 50,155 | 5.00 |

On July 2, 2013, the Board of Governors of the Federal Reserve System approved final rules that substantially amend the regulatory risk-based capital rules applicable to the Company and the Bank. The final rules implement the Basel III regulatory capital reforms, as well as certain changes required by the Dodd-Frank Act, which will require institutions to, among other things, have more capital and a higher quality of capital by increasing the minimum regulatory capital ratios, and requiring capital buffers. The new rules become effective for the Company and the Bank on January 1, 2015, with an implementation period that stretches to 2019. The Company is continuing to review the impact of these new rules and currently expects that its capital position will be more than adequate to meet the revised regulatory capital requirements upon their implementation. For a more detailed discussion see the Capital Resources section of the MD&A.

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****14. Segment Results**

The financial performance of the Company is also monitored by an internal funds transfer pricing profitability measurement system which produces line of business results and key performance measures. The Company's major business units include retail banking, commercial lending, trust, and investment/parent. The reported results reflect the underlying economics of the business segments. Expenses for centrally provided services are allocated based upon the cost and estimated usage of those services. The businesses are match-funded and interest rate risk is centrally managed and accounted for within the investment/parent business segment. The key performance measure the Company focuses on for each business segment is net income contribution.

Retail banking includes the deposit-gathering branch franchise and lending to both individuals and small businesses. Lending activities include residential mortgage loans, direct consumer loans, and small business commercial loans. Commercial banking to businesses includes commercial loans, and commercial real-estate loans. The trust segment contains our wealth management businesses which include the Trust Company, West Chester Capital Advisors (WCCA), our registered investment advisory firm and financial services. Wealth management includes personal trust products and services such as personal portfolio investment management, estate planning and administration, custodial services and pre-need trusts. Also, institutional trust products and services such as 401(k) plans, defined benefit and defined contribution employee benefit plans, and individual retirement accounts are included in this segment. Financial services include the sale of mutual funds, annuities, and insurance products. The Wealth management businesses also includes the union collective investment funds, namely the ERECT and BUILD funds which are designed to use union pension dollars in construction projects that utilize union labor. The company recognized goodwill in connection with the acquisition of WCCA in 2007. In the third quarter of 2014, the Company performed a goodwill impairment test and determined that the fair value of WCCA was less than its carrying value and, accordingly, recorded an impairment charge of \$669,000, which is included in net income (loss) for the Trust segment in the table below. The goodwill impairment charge was the result of a reduction in earnings power caused by the departure of WCCA's former CEO and subsequent loss of a meaningful number of clients. The investment/parent includes the net results of investment securities and borrowing activities, general corporate expenses not allocated to the business segments, interest expense on guaranteed junior subordinated deferrable interest debentures, and centralized interest rate risk management. Inter-segment revenues were not material.

The contribution of the major business segments to the Consolidated Statements of Operations for the three and nine months ended September 30, 2014 and 2013 were as follows (in thousands):

|                    | Three months ended<br>September 30, 2014 |                      | Nine months ended<br>September 30, 2014 |                      | September 30,<br>2014 |
|--------------------|--|----------------------|---|----------------------|-----------------------|
|                    | Total<br>revenue                         | Net income<br>(loss) | Total<br>revenue                        | Net income<br>(loss) | Total<br>assets       |
| Retail banking     | \$ 6,651                                 | \$ 706               | \$ 19,238                               | \$ 1,671             | \$ 359,932            |
| Commercial banking | 4,279                                    | 1,141                | 12,691                                  | 3,267                | 557,909               |
| Trust              | 1,907                                    | (432 )               | 6,062                                   | 232                  | 4,457                 |
| Investment/Parent  | (841 )                                   | (1,050 )             | (1,916 )                                | (2,896 )             | 148,133               |
| Total              | \$ 11,996                                | \$ 365               | \$ 36,075                               | \$ 2,274             | \$ 1,070,431          |

|                    | Three months ended<br>September 30, 2013 |                      | Nine months ended<br>September 30, 2013 |                      | December 31,<br>2013 |
|--------------------|--|----------------------|---|----------------------|----------------------|
|                    | Total<br>revenue                         | Net income<br>(loss) | Total<br>revenue                        | Net income<br>(loss) | Total<br>assets      |
| Retail banking     | \$ 6,775                                 | \$ 729               | \$ 20,285                               | \$ 2,339             | \$ 347,823           |
| Commercial banking | 4,075                                    | 1,136                | 11,943                                  | 3,189                | 545,556              |
| Trust              | 2,048                                    | 310                  | 6,216                                   | 816                  | 4,722                |
| Investment/Parent  | (712 )                                   | (949 )               | (2,304 )                                | (2,992 )             | 157,935              |
| Total              | \$ 12,186                                | \$ 1,226             | \$ 36,140                               | \$ 3,352             | \$ 1,056,036         |

26

---

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****15. Commitments and Contingent Liabilities**

The Company had various outstanding commitments to extend credit approximating \$172.1 million and standby letters of credit of \$12.1 million as of September 30, 2014. The Company's exposure to credit loss in the event of nonperformance by the other party to these commitments to extend credit and standby letters of credit is represented by their contractual amounts. The Bank uses the same credit and collateral policies in making commitments and conditional obligations as for all other lending.

Additionally, the Company is also subject to a number of asserted and unasserted potential claims encountered in the normal course of business. In the opinion of the Company, neither the resolution of these claims nor the funding of these credit commitments will have a material adverse effect on the Company's consolidated financial position, results of operation or cash flows.

**16. Pension Benefits**

The Company has a noncontributory defined benefit pension plan covering certain employees who work at least 1,000 hours per year. The participants shall have a vested interest in their accrued benefit after five full years of service. The benefits of the plan are based upon the employee's years of service and average annual earnings for the highest five consecutive calendar years during the final ten year period of employment. Plan assets are primarily debt securities (including US Treasury and Agency securities, corporate notes and bonds), listed common stocks (including shares of AmeriServ Financial, Inc. common stock which is limited to 10% of the plan's assets), mutual funds, and short-term cash equivalent instruments. The net periodic pension cost for the three and nine months ended September 30, 2014 and 2013 were as follows (in thousands):

|   | Three months ended<br>September 30, |        | Nine months ended<br>September 30, |          |
|---|-------------------------------------|--------|------------------------------------|----------|
|   | 2014                                | 2013   | 2014                               | 2013     |
| Components of net periodic benefit cost |                                     |        |                                    |          |
| Service cost                            | \$ 430                              | \$ 453 | \$ 1,290                           | \$ 1,359 |
| Interest cost                           | 331                                 | 291    | 993                                | 873      |
| Expected return on plan assets          | (498 )                              | (440 ) | (1,494 )                           | (1,320 ) |
| Amortization of prior year service cost | (5 )                                | (5 )   | (15 )                              | (15 )    |
| Amortization of transition asset        |                                     | (2 )   |                                    | (6 )     |
| Recognized net actuarial loss           | 272                                 | 341    | 816                                | 1,023    |
| Net periodic pension cost               | \$ 530                              | \$ 638 | \$ 1,590                           | \$ 1,914 |

The Company implemented a soft freeze of its defined benefit pension plan to provide that non-union employees hired on or after January 1, 2013 and union employees hired on or after January 1, 2014 are not eligible to participate in the pension plan. Instead, such employees are eligible to participate in a qualified 401(k) plan. This change was made to help reduce pension costs in future periods.

## 17. Disclosures about Fair Value Measurements

The following disclosures establish a hierarchal disclosure framework associated with the level of pricing observability utilized in measuring assets and liabilities at fair value. The three broad levels defined within this hierarchy are as follows:

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.

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****17. Disclosures about Fair Value Measurements (continued)****Assets and Liability Measured on a Recurring Basis**

Securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quoted market spreads, cash flows, the US Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things.

The following tables present the assets reported on the Consolidated Balance Sheets at their fair value as of September 30, 2014 and December 31, 2013, 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.

Assets and liability measured at fair value on a recurring basis are summarized below (in thousands):

|                                      | Fair Value Measurements at September 30,<br>2014 Using |           |           |           |
|--------------------------------------|--|-----------|-----------|-----------|
|                                      | Total  | (Level 1) | (Level 2) | (Level 3) |
| US Agency securities                 | \$ 6,905   | \$        | \$ 6,905  | \$        |
| US Agency mortgage-backed securities | 110,685  |           | 110,685   |           |
| Corporate bonds                      | 13,383   |           | 13,383    |           |

|                                      | Fair Value Measurements at December 31,<br>2013 Using |           |           |           |
|--------------------------------------|---|-----------|-----------|-----------|
|                                      | Total   | (Level 1) | (Level 2) | (Level 3) |
| US Agency securities                 | \$ 6,835  | \$        | \$ 6,835  | \$        |
| US Agency mortgage-backed securities | 123,382   |           | 123,382   |           |
| Corporate bonds                      | 11,761  |           | 11,761    |           |

**Assets Measured on a Non-recurring Basis**

Loans considered impaired are loans for which, based on current information and events, it is probable that the creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. As detailed in the allowance for loan loss footnote, impaired loans are reported at fair value of the underlying collateral if the repayment is expected solely from the collateral. Collateral values are estimated using Level 3 inputs based on observable market data which at times are discounted. At September 30, 2014, impaired loans with a carrying value of \$1.4 million were reduced by a specific valuation allowance totaling \$547,000 resulting in a net fair value of \$897,000. At December 31, 2013, impaired loans with a carrying value of \$3.1 million were reduced by a specific valuation allowance totaling \$813,000 million resulting in a net fair value of \$2.3 million.



Other real estate owned is measured at fair value based on appraisals, less cost to sell at the date of foreclosure. Valuations are periodically performed by management. Income and expenses from operations and changes in valuation allowance are included in the net expenses from OREO.

Assets measured at fair value on a non-recurring basis are summarized below (in thousands, except range data):

|                         | Fair Value Measurements at September 30,<br>2014 Using |           |           |           |
|-------------------------|--|-----------|-----------|-----------|
|                         | Total  | (Level 1) | (Level 2) | (Level 3) |
| Impaired loans          | \$ 897   | \$        | \$        | \$ 897    |
| Other real estate owned | 683  |           |           | 683       |

|                         | Fair Value Measurements at December 31,<br>2013 Using |           |           |           |
|-------------------------|---|-----------|-----------|-----------|
|                         | Total   | (Level 1) | (Level 2) | (Level 3) |
| Impaired loans          | \$ 2,253  | \$        | \$        | \$ 2,253  |
| Other real estate owned | 1,017   |           |           | 1,017     |

28

---

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****17. Disclosures about Fair Value Measurements (continued)**

| September 30, 2014      | Quantitative Information About Level 3 Fair Value Measurements |  |   |                                    |
|-------------------------|--|--|---|------------------------------------|
|                         | Fair Value Estimate  | Valuation Techniques                       | Unobservable Input  | Range (Wgtd Ave)                   |
| Impaired loans          | \$897  | Appraisal of collateral <sup>(1)</sup>     | Appraisal adjustments <sup>(2)</sup><br>Liquidation expenses <sup>(2)</sup> | 0% to 35% (30)%<br>1% to 15% (10)% |
| Other real estate owned | 683  | Appraisal of collateral <sup>(1),(3)</sup> | Appraisal adjustments <sup>(2)</sup><br>Liquidation expenses <sup>(2)</sup> | 0% to 48% (38)%<br>1% to 20% (10)% |

| December 31, 2013       | Quantitative Information About Level 3 Fair Value Measurements |  |   |                                    |
|-------------------------|--|--|---|------------------------------------|
|                         | Fair Value Estimate  | Valuation Techniques                       | Unobservable Input  | Range (Wgtd Ave)                   |
| Impaired loans          | \$2,253  | Appraisal of collateral <sup>(1)</sup>     | Appraisal adjustments <sup>(2)</sup><br>Liquidation expenses <sup>(2)</sup> | 0% to 37% (30)%<br>1% to 15% (10)% |
| Other real estate owned | 1,017  | Appraisal of collateral <sup>(1),(3)</sup> | Appraisal adjustments <sup>(2)</sup><br>Liquidation expenses <sup>(2)</sup> | 0% to 48% (38)%<br>1% to 20% (10)% |

(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.

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

**DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS**

For the Company, as for most financial institutions, approximately 90% of its assets and liabilities are considered financial instruments. Many of the Company's financial instruments, however, lack an available trading market characterized by a willing buyer and willing seller engaging in an exchange transaction. Therefore, significant estimates and present value calculations were used by the Company for the purpose of this disclosure.

Fair values have been determined by the Company using independent third party valuations that use the best available data (Level 2) and an estimation methodology (Level 3) the Company believes is suitable for each category of financial instruments. Management believes that cash, cash equivalents, and loans and deposits with floating interest rates have estimated fair values which approximate the recorded book balances. The estimation methodologies used, the estimated fair values based on US GAAP measurements, and recorded book balances at September 30, 2014 and December 31, 2013, were as follows (in thousands):

|   | September 30, 2014 |            |           |           |           |
|---|--------------------|------------|-----------|-----------|-----------|
|   | Carrying Value     | Fair Value | (Level 1) | (Level 2) | (Level 3) |
| <b>FINANCIAL ASSETS:</b>                                  |                    |            |           |           |           |
| Cash and cash equivalents                                 | \$23,482           | \$23,482   | \$23,482  | \$        | \$        |
| Investment securities AFS                                 | 130,973            | 130,973    |           | 130,973   |           |
| Investment securities HTM                                 | 19,498             | 19,626     |           | 16,657    | 2,969     |
| Regulatory stock  | 7,152              | 7,152      | 7,152     |           |           |
| Loans held for sale                                       | 3,964              | 4,043      | 4,043     |           |           |
| Loans, net of allowance for loan loss and unearned income | 804,341            | 803,931    |           |           | 803,931   |
| Accrued interest income receivable                        | 3,280              | 3,280      | 3,280     |           |           |
| Bank owned life insurance                                 | 37,228             | 37,228     | 37,228    |           |           |

29

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****17. Disclosures about Fair Value Measurements (continued)**

|                                    | September 30, 2014 |            |            |           |           |
|------------------------------------|--------------------|------------|------------|-----------|-----------|
|                                    | Carrying Value     | Fair Value | (Level 1)  | (Level 2) | (Level 3) |
| <b>FINANCIAL LIABILITIES:</b>      |                    |            |            |           |           |
| Deposits with no stated maturities | \$ 576,943         | \$ 576,943 | \$ 576,943 | \$        | \$        |
| Deposits with stated maturities    | 295,227            | 289,078    |            |           | 289,078   |
| Short-term borrowings              | 26,438             | 26,438     | 26,438     |           |           |
| All other borrowings               | 50,085             | 53,479     |            |           | 53,479    |
| Accrued interest payable           | 1,611              | 1,611      | 1,611      |           |           |

|   | December 31, 2013 |            |            |           |           |
|---|-------------------|------------|------------|-----------|-----------|
|   | Carrying Value    | Fair Value | (Level 1)  | (Level 2) | (Level 3) |
| <b>FINANCIAL ASSETS:</b>                                  |                   |            |            |           |           |
| Cash and cash equivalents                                 | \$ 30,066         | \$ 30,066  | \$ 30,066  | \$        | \$        |
| Investment securities AFS                                 | 141,978           | 141,978    |            | 141,978   |           |
| Investment securities HTM                                 | 18,187            | 17,788     |            | 14,822    | 2,966     |
| Regulatory stock  | 6,802             | 6,802      | 6,802      |           |           |
| Loans held for sale                                       | 3,402             | 3,453      | 3,453      |           |           |
| Loans, net of allowance for loan loss and unearned income | 773,242           | 771,460    |            |           | 771,460   |
| Accrued interest income receivable                        | 2,908             | 2,908      | 2,908      |           |           |
| Bank owned life insurance                                 | 36,669            | 36,669     | 36,669     |           |           |
| <b>FINANCIAL LIABILITIES:</b>                             |                   |            |            |           |           |
| Deposits with no stated maturities                        | \$ 546,384        | \$ 546,384 | \$ 546,384 | \$        | \$        |
| Deposits with stated maturities                           | 308,138           | 313,272    |            |           | 313,272   |
| Short-term borrowings                                     | 41,555            | 41,555     | 41,555     |           |           |
| All other borrowings                                      | 38,085            | 40,598     |            |           | 40,598    |
| Accrued interest payable                                  | 1,784             | 1,784      | 1,784      |           |           |

The fair value of cash and cash equivalents, regulatory stock, accrued interest income receivable, short-term borrowings, and accrued interest payable are equal to the current carrying value.

The fair value of investment securities is equal to the available quoted market price for similar securities. The fair value measurements consider observable data that may include dealer quoted market spreads, cash flows, the US Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. The Level 3 securities are valued by discounted cash flows using the US Treasury rate for the remaining term of the securities.

Loans held for sale are priced individually at market rates on the day that the loan is locked for commitment with an investor. All loans in the held for sale account conform to Fannie Mae underwriting guidelines, with the specific intent of the loan being purchased by an investor at the predetermined rate structure. Loans in the held for sale account have specific delivery dates that must be executed to protect the pricing commitment (typically a 30, 45, or 60 day lock period).

The net loan portfolio has been valued using a present value discounted cash flow. The discount rate used in these calculations is based upon the treasury yield curve adjusted for non-interest operating costs, credit loss, current market prices and assumed prepayment risk.

The fair value of bank owned life insurance is based upon the cash surrender value of the underlying policies and matches the book value.

30

---

TABLE OF CONTENTS

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**17. Disclosures about Fair Value Measurements (continued)**

Deposits with stated maturities have been valued using a present value discounted cash flow with a discount rate approximating current market for similar assets and liabilities. Deposits with no stated maturities have an estimated fair value equal to both the amount payable on demand and the recorded book balance.

The fair value of all other borrowings is 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.

Commitments to extend credit and standby letters of credit are financial instruments generally not subject to sale, and fair values are not readily available. The carrying value, represented by the net deferred fee arising from the unrecognized commitment, 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, is not considered material for disclosure. The contractual amounts of unfunded commitments are presented in Note 15.

Changes in assumptions or estimation methodologies may have a material effect on these estimated fair values. The Company's remaining assets and liabilities which are not considered financial instruments have not been valued differently than has been customary under historical cost accounting.

TABLE OF CONTENTS

**Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS ( M.D. & A. )**

.....**2014 THIRD QUARTER SUMMARY OVERVIEW**.....AmeriServ reported net income available to common shareholders of \$312,000 or \$0.02 per diluted share for the third quarter of 2014. This represents a decline from the \$1,173,000 or \$0.06 per diluted share reported for the third quarter of 2013. This means that for the nine month period ending on September 30, 2014, AmeriServ has reported net income available to common shareholders of \$2,116,000 or \$0.11 per diluted share as compared to the same period of 2013 when net income available to common shareholders was \$3,195,000 or \$0.17 per diluted share. These results reflect a series of actions taken by the Board and management with the goal of improving future profitability. However, we will first discuss the impact of a negative event which occurred at West Chester Capital Advisors (WCCA), our registered investment advisory subsidiary that was disclosed previously in a press release and 8-K filing on September 25, 2014.

In 2007, AmeriServ acquired WCCA in its entirety, as a logical addition to the strong wealth management offerings of AmeriServ Trust and Financial Services (Trust Company). The founder of WCCA became an employee and chief executive officer of WCCA, and remained so designated until he submitted his resignation effective January 31, 2014. Since 2011, the Trust Company management has been working to integrate the investment expertise of WCCA and the Trust Company into a single coordinated unit within WCCA to offer clients expanded investment opportunities. However, following his separation from WCCA on January 31, 2014 and during the subsequent litigation involving violations of certain restrictions contained within his employment agreement, some customers chose to move their investment accounts from WCCA. This event caused a reduction in WCCA s projected earnings capacity which resulted in AmeriServ reducing the value of the goodwill attributed to WCCA by \$669,000 in the third quarter of 2014.

We are also focused on ways to improve the overall profitability of the franchise. Our first concern was to be certain that our products and services have been performing well in the market place. It goes without saying that satisfied customers are the key to the future. In this review, we have noted that loans outstanding have increased since September 30, 2013 by over \$54 million, or 7.1%, in a rather lackluster economy. During that same period, customer deposits have increased by \$20 million, or 2.4%, aiding our loan to deposit ratio. In addition, the Trust Company subsidiary has increased its fee revenues by \$248,000, or 4.5%, since September 30, 2013. We believe these are indicators of AmeriServ s return to a community banking strategy in recent years. However, our inquiries also revealed that in this very same period AmeriServ s non-interest expenses increased by \$1,124,000, or 3.6%. The simple fact became apparent that this expense growth was reducing the impact of the positive growth in revenues. During the remainder of 2014 and continuing into 2015, and perhaps beyond, we are taking a series of specific actions to reduce this growth of expenses.

The Federal Reserve continues to pursue its Zero Interest Rate program. The actual success of this program is debated constantly, but it is believed that the program has had a severe negative impact on savers, on community bank profitability and on pension funds. The defined benefit pension plan, which was common in the latter half of the 20<sup>th</sup> Century, has been disappearing as its financial viability has diminished. During 2013 and 2014, AmeriServ has taken the necessary steps to reduce its defined benefit pension plan during the next few years. The pensions of present employees will be protected, but new employees will be offered the popular alternative, the defined contribution plan. This action will be a positive for AmeriServ profitability as the transition proceeds.

As AmeriServ s customer services have expanded, there has been an increasing workload for many AmeriServ employees. Therefore, during 2014, AmeriServ invited a well-known consulting firm to analyze our procedures and

make cost rationalization recommendations based on their opinion of best practices in banking. The bill for the analysis was \$150,000, but it contained 50 separate recommendations. We expect that the savings potential will exceed the amount of the bill as the recommendations are implemented in 2014 and beyond. We believe this program will have a positive effect on earnings per share by increasing efficiency in every department involved in the analysis.

Banking is becoming a very technologically oriented industry, incorporating smart phones, iPads, and creative new software applications. Admittedly, at first, the primary thrust of technology in banking was to shrink costs. But as we become more proficient, we have found it also can improve customer service



TABLE OF CONTENTS

and provide entirely new and unforeseen advantages. During 2014, the fast growing Trust Company converted to an entirely new state of the art technology platform. We should note that new technology always has an up-front cost and a period of conversion and staff training. We believe the gains will justify the costs. Therefore, the intelligent use of advanced technology has been, and will be, a part of our search for better customer service and more robust profits for our shareholders.

Now let us gather this all together in something of a synergistic context. The basic theme is actually quite simple. We believe AmeriServ is performing well in bringing customers to use AmeriServ products and services. This is because the products themselves are good, and the staff is experienced and motivated. But AmeriServ must seek improvements in efficiency. This is a company-wide challenge and everyone is being asked to contribute.

Over the last 10 years, AmeriServ has become an integral part of its markets. AmeriServ is a safe and sound community bank with a Trust Company that has posted four consecutive years of double digit bottom line growth. This experience has convinced us that community banks can have a bright future. But we also remember the time honored axiom that nothing of real value is seldom achieved without hard work. Our job is to make AmeriServ not merely safe and sound but also a more efficient company with improving profitability.

## THREE MONTHS ENDED SEPTEMBER 30, 2014 VS. THREE MONTHS ENDED SEPTEMBER 30, 2013

....**PERFORMANCE OVERVIEW**....The following table summarizes some of the Company's key performance indicators (in thousands, except per share and ratios).

|   | Three months ended September 30, 2014 | Three months ended September 30, 2013 |
|---|---------------------------------------|---------------------------------------|
| Net income                                  | \$ 365                                | \$ 1,226                              |
| Net income available to common shareholders | 312                                   | 1,173                                 |
| Diluted earnings per share                  | 0.02                                  | 0.06                                  |
| Return on average assets (annualized)       | 0.14 %                                | 0.47 %                                |
| Return on average equity (annualized)       | 1.25 %                                | 4.44 %                                |

The Company reported third quarter 2014 net income available to common shareholders of \$312,000, or \$0.02 per diluted common share. This compares to net income available to common shareholders of \$1,173,000, or \$0.06 per diluted common share, reported for the third quarter of 2013. As previously disclosed, the Company's third quarter 2014 financial performance was negatively impacted by a \$669,000 goodwill impairment charge related to its registered investment advisory subsidiary and approximately \$150,000 of non-recurring expenses related to a profitability improvement project. Both of these items contributed to higher non-interest expense in the third quarter of 2014. Total revenue also declined in the third quarter of 2014 as a \$203,000 increase in net interest income was more than offset by a \$393,000 reduction in non-interest income.

....**NET INTEREST INCOME AND MARGIN**....The Company's net interest income represents the amount by which interest income on average earning assets exceeds interest paid on average interest bearing liabilities. Net interest income is a primary source of the Company's earnings, and it is affected by interest rate fluctuations as well as changes in the amount and mix of average earning assets and average interest bearing liabilities. The following table compares the Company's net interest income performance for the third quarter of 2014 to the third quarter of 2013 (in thousands, except percentages):

|                     | Three months<br>ended<br>September 30,<br>2014 | Three months<br>ended<br>September 30,<br>2013 | \$<br>Change | %<br>Change |
|---------------------|--|--|--------------|-------------|
| Interest income     | \$ 10,019                                      | \$ 9,811                                       | \$ 208       | 2.1 %       |
| Interest expense    | 1,616  | 1,611  | 5            | 0.3         |
| Net interest income | \$ 8,403                                       | \$ 8,200                                       | \$ 203       | 2.5         |
| Net interest margin | 3.42 %   | 3.46 %   | (0.04 )      | N/M         |

N/M not meaningful

TABLE OF CONTENTS

The Company's net interest income in the third quarter of 2014 increased by \$203,000, or 2.5%, when compared to the third quarter of 2013. The Company's net interest margin of 3.42% for the third quarter of 2014 was four basis points lower than the net interest margin of 3.46% for the third quarter 2013. We believe that this performance demonstrates that the recent pace of net interest margin contraction has slowed from the pace of margin decline experienced over the previous two years. The Company has been able to mitigate this net interest margin pressure and increase net interest income by both growing its earning assets and reducing its cost of funds. Specifically, the earning asset growth has occurred in the loan portfolio as total loans averaged \$809 million in the third quarter of 2014 which is \$54 million, or 7.1%, higher than the \$755 million average for the same period in 2013. This loan growth reflects the successful results of the Company's more intensive sales calling efforts, with an emphasis on generating commercial loans and owner occupied commercial real estate loans, which qualify as Small Business Lending Fund (SBLF) loans.

As a result of this growth in SBLF qualified loans, the Company has locked in the lowest preferred dividend rate available under the program of 1% until the first quarter of 2016. Interest income in 2014 has also benefitted from reduced premium amortization on mortgage backed securities due to slower mortgage prepayment speeds.

Total interest expense for the third quarter of 2014 only increased by \$5,000 from the 2013 third quarter due to the Company's proactive efforts to reduce deposit costs. The Company experienced growth in deposits which reflects the loyalty of our core deposit base and ongoing efforts to cross sell new loan customers into deposit products.

Specifically, total deposits averaged \$877 million for the third quarter of 2014 which is \$22 million, or 2.6%, higher than the \$855 million average in the third quarter of 2013. The Company's loan to deposit ratio has increased to 93.3% at September 30, 2014 from 89.3% at September 30, 2013.

The table that follows provides an analysis of net interest income on a tax-equivalent basis for the three month periods ended September 30, 2014 and September 30, 2013 setting forth (i) average assets, liabilities, and stockholders' equity, (ii) interest income earned on interest earning assets and interest expense paid on interest bearing liabilities, (iii) average yields earned on interest earning assets and average rates paid on interest bearing liabilities, (iv) the Company's interest rate spread (the difference between the average yield earned on interest earning assets and the average rate paid on interest bearing liabilities), and (v) the Company's net interest margin (net interest income as a percentage of average total interest earning assets). For purposes of these tables, loan balances do include non-accrual loans, and interest income on loans includes loan fees or amortization of such fees which have been deferred, as well as interest recorded on certain non-accrual loans as cash is received. Additionally, a tax rate of 34% is used to compute tax-equivalent yields.

TABLE OF CONTENTS**Three months ended September 30** (In thousands, except percentages)

|   | 2014               |                                |            | 2013               |                                |            |
|---|--------------------|--------------------------------|------------|--------------------|--------------------------------|------------|
|   | Average<br>Balance | Interest<br>Income/<br>Expense | Yield/Rate | Average<br>Balance | Interest<br>Income/<br>Expense | Yield/Rate |
| Interest earning assets:                                      |                    |                                |            |                    |                                |            |
| Loans and loans held for sale, net of unearned income         | \$808,731          | \$9,025                        | 4.40%      | \$754,996          | \$8,771                        | 4.57%      |
| Interest bearing deposits                                     | 7,207              | 1                              | 0.03       | 6,542              | 1                              | 0.06       |
| Short-term investment in money market funds                   | 1,449              | 2                              | 0.66       | 2,632              | 1                              | 0.21       |
| Federal funds sold  |                    |                                |            | 318                |                                | 0.03       |
| Investment securities AFS                                     | 136,172            | 859                            | 2.53       | 153,925            | 911                            | 2.37       |
| Investment securities HTM                                     | 19,644             | 138                            | 2.81       | 18,955             | 133                            | 2.81       |
| Total investment securities                                   | 155,816            | 997                            | 2.56       | 172,880            | 1,044                          | 2.42       |
| Total interest earning assets/<br>interest income             | 973,203            | 10,025                         | 4.08       | 937,368            | 9,817                          | 4.15       |
| Non-interest earning assets:                                  |                    |                                |            |                    |                                |            |
| Cash and due from banks                                       | 16,027             |                                |            | 16,469             |                                |            |
| Premises and equipment  | 13,477             |                                |            | 13,018             |                                |            |
| Other assets  | 69,528             |                                |            | 72,125             |                                |            |
| Allowance for loan losses                                     | (10,040 )          |                                |            | (11,177 )          |                                |            |
| TOTAL ASSETS  | \$1,062,195        |                                |            | \$1,027,803        |                                |            |
| Interest bearing liabilities:                                 |                    |                                |            |                    |                                |            |
| Interest bearing deposits:                                    |                    |                                |            |                    |                                |            |
| Interest bearing demand                                       | \$104,197          | \$52                           | 0.20%      | \$79,224           | \$37                           | 0.19%      |
| Savings   | 89,522             | 36                             | 0.16       | 88,270             | 35                             | 0.16       |
| Money markets   | 228,353            | 196                            | 0.34       | 211,725            | 182                            | 0.34       |
| Time deposits   | 299,730            | 953                            | 1.26       | 315,890            | 1,020                          | 1.28       |
| Total interest bearing deposits                               | 721,802            | 1,237                          | 0.69       | 695,109            | 1,274                          | 0.73       |
| Short-term borrowings   | 12,933             | 10                             | 0.27       | 18,711             | 12                             | 0.26       |
| Advances from Federal Home Loan Bank                          | 34,729             | 89                             | 0.97       | 20,193             | 45                             | 0.88       |
| Guaranteed junior subordinated deferrable interest debentures | 13,085             | 280                            | 8.57       | 13,085             | 280                            | 8.57       |
| Total interest bearing liabilities/<br>interest expense       | 782,549            | 1,616                          | 0.82       | 747,098            | 1,611                          | 0.86       |
| Non-interest bearing liabilities:                             |                    |                                |            |                    |                                |            |
| Demand deposits   | 155,157            |                                |            | 159,627            |                                |            |
| Other liabilities   | 8,143              |                                |            | 11,622             |                                |            |
| Shareholders equity   | 116,346            |                                |            | 109,456            |                                |            |
| TOTAL LIABILITIES AND<br>SHAREHOLDERS EQUITY                  | \$1,062,195        |                                |            | \$1,027,803        |                                |            |
| Interest rate spread  |                    |                                | 3.26       |                    |                                | 3.29       |
| Net interest income/Net interest margin                       |                    | 8,409                          | 3.42%      |                    | 8,206                          | 3.46%      |

|                           |         |         |
|---------------------------|---------|---------|
| Tax-equivalent adjustment | (6 )    | (6 )    |
| Net Interest Income       | \$8,403 | \$8,200 |

---

35

TABLE OF CONTENTS

**.....PROVISION FOR LOAN LOSSES.....**The Company did not record a provision for loan losses in the third quarter of 2014 or 2013. The Company continued to maintain outstanding asset quality in the third quarter of 2014. At September 30, 2014, non-performing assets totaled \$3.9 million, or 0.48% of total loans, which represents the second time that our non-performing assets have been under \$4 million in the past seven quarters. The Company experienced net loan charge-offs of \$568,000, or 0.28% of total loans, in the third quarter of 2014 compared to net loan recoveries of \$38,000, or 0.02% of total loans, in the third quarter of 2013. The third quarter of 2014 represented the first quarter this year that we experienced net loan charge-offs as the Company had net loan recoveries in both the first and second quarter of 2014. When determining the provision for loan losses, the Company considers a number of factors, some of which include periodic credit reviews, non-performing assets, loan delinquency and charge-off trends, concentrations of credit, loan volume trends and broader local and national economic trends. In summary, the allowance for loan losses provided a strong 298% coverage of non-performing loans at September 30, 2014, compared to 327% coverage of non-performing loans at December 31, 2013.

**.....NON-INTEREST INCOME.....**Non-interest income for the third quarter of 2014 totaled \$3.6 million and decreased \$393,000, or 9.9%, from the third quarter 2013 performance. Factors contributing to this lower level of non-interest income for the quarter included:

- \* a \$140,000 decrease in other income due largely to reduced gains realized on the sale of other real estate owned and lower financial services commission revenue.
- \* a \$86,000, or 4.5%, decrease in trust and investment advisory fees resulting from client attrition at WCCA due to the departure of its former CEO in that business earlier in January 2014.
- \* a \$66,000 reduction in gains realized on the sale of investment securities in the third quarter of 2014 as the Company
- \* took advantage of market opportunities to sell certain rapidly repaying mortgage backed securities in the third quarter of 2013.

**.....NON-INTEREST EXPENSE.....**Non-interest expense for the third quarter of 2014 totaled \$11.2 million and increased by \$830,000, or 8.0%, from the prior year's third quarter. Factors contributing to the higher non-interest expense in the quarter included:

the recognition of a \$669,000 goodwill impairment charge during the third quarter of 2014. The voluntary departure of WCCA's former CEO, and the related litigation against him for violations of his employment agreement, caused

- \* disruption within the WCCA customer base during 2014. This disruption ultimately led to the loss of certain clients and a reduction in the projected earnings capacity of WCCA which caused the Company to incur the goodwill impairment charge.

a \$326,000 increase in professional fees due in part to approximately \$150,000 of consulting costs related to a profitability improvement project in the third quarter of 2014. The Company expects to achieve a significant

- \* payback on the costs related to the profitability improvement project as we evaluate and prioritize recommendations for implementation beginning in the fourth quarter of 2014 and continuing into 2015. The remainder of the increase in professional fees was due to new recurring costs related to outsourcing our computer operations and statement processing to a third party vendor.

- \* a \$112,000, or 1.8%, decrease in salaries and employee benefits due to lower pension expense and incentive compensation expense in the third quarter of 2014.

TABLE OF CONTENTS**NINE MONTHS ENDED SEPTEMBER 30, 2014 VS. NINE MONTHS ENDED SEPTEMBER 30, 2013**

.....**PERFORMANCE OVERVIEW**.....The following table summarizes some of the Company's key performance indicators (in thousands, except per share and ratios).

|   | Nine months ended September 30, 2014 |   | Nine months ended September 30, 2013 |   |
|---|--------------------------------------|---|--------------------------------------|---|
| Net income                                  | \$ 2,274                             |   | \$ 3,352                             |   |
| Net income available to common shareholders | 2,116                                |   | 3,195                                |   |
| Diluted earnings per share                  | 0.11                                 |   | 0.17                                 |   |
| Return on average assets (annualized)       | 0.29                                 | % | 0.44                                 | % |
| Return on average equity (annualized)       | 2.64                                 | % | 4.05                                 | % |

For the nine month period ended September 30, 2014, the Company reported net income available to common shareholders of \$2,116,000, or \$0.11 per diluted share. This represented a 35.3% decline in earnings per share from the same nine month period in 2013 where net income available to common shareholders totaled \$3,195,000 or \$0.17 per diluted common share. The factors causing the decline in earnings in 2014 were reduced non-interest income and higher non-interest expense. These negative items more than offset a 4.3% increase in net interest income in the first nine months of 2014 due to the previously mentioned solid loan growth the Company has achieved over the past year.

.....**NET INTEREST INCOME AND MARGIN**.....The following table compares the Company's net interest income performance for the first nine months of 2014 to the first nine months of 2013 (in thousands, except percentages):

|                     | Nine months ended September 30, 2014 |   | Nine months ended September 30, 2013 |   | \$       | %      |
|---------------------|--------------------------------------|---|--------------------------------------|---|----------|--------|
|                     |                                      |   |                                      |   | Chang    | Change |
| Interest income     | \$ 30,097                            |   | \$ 29,140                            |   | \$ 957   | 3.3 %  |
| Interest expense    | 4,785                                |   | 4,877                                |   | (92 )    | (1.9 ) |
| Net interest income | \$ 25,312                            |   | \$ 24,263                            |   | \$ 1,049 | 4.3    |
| Net interest margin | 3.48                                 | % | 3.52                                 | % | (0.04 )  | N/M    |

N/M not meaningful

The Company's net interest income in the first nine months of 2014 increased by \$1.0 million or 4.3% when compared to the first nine months of 2013. The Company's net interest margin of 3.48% for the first nine months of 2014 was four basis points lower than the net interest margin of 3.52% for the first nine months of 2013. The reduced net interest margin demonstrates the impact of Federal Reserve low interest rate policies which have pressured interest revenue. The Company has been able to mitigate this net interest margin pressure and to increase net interest income by both growing its earning assets and reducing its cost of funds. Specifically, the earning asset growth has occurred in the loan portfolio as total loans averaged \$797 million in the first nine months of 2014 which is \$60 million, or 8.2%, higher than the \$737 million average for the same period in 2013. Interest income in 2014 has also benefitted from reduced premium amortization on mortgage backed securities due to slower mortgage prepayment speeds which

has caused the yield on the total securities portfolio to increase by 11 basis points to 2.60% in the first nine months of 2014. The size of the total securities portfolio and short term investments has decreased on average by \$10 million in 2014 as the Company has utilized cash flow from these instruments to help fund the previously mentioned loan growth.

Total interest expense for the first nine months of 2014 declined by \$92,000 from the first nine months of 2013 due to the Company's proactive efforts to reduce deposit costs. Even with this reduction in deposit costs, the Company still experienced growth in deposits which reflects the loyalty of our core deposit base and ongoing efforts to cross sell new loan customers into deposit products. Specifically, total deposits averaged a record level of \$870 million for the first nine months of 2014 which is \$26 million, or 3.1%, higher than the \$844 million average in the first nine months of 2013. This decreased interest cost for deposits has been partially offset by a \$132,000 increase in the interest cost for borrowings as the Company has utilized more FHLB term advances to extend borrowings and provide protection against rising interest rates in future periods. These FHLB term advances have maturities ranging between three and five years.



TABLE OF CONTENTS

The table that follows provides an analysis of net interest income on a tax-equivalent basis for the nine month periods ended September 30, 2014 and September 30, 2013. For a detailed discussion of the components and assumptions included in the table, see the paragraph before the quarterly table on page 34.

**Nine months ended September 30** (In thousands, except percentages)

|   | 2014               |                                |            | 2013               |                                |            |
|---|--------------------|--------------------------------|------------|--------------------|--------------------------------|------------|
|   | Average<br>Balance | Interest<br>Income/<br>Expense | Yield/Rate | Average<br>Balance | Interest<br>Income/<br>Expense | Yield/Rate |
| Interest earning assets:                                      |                    |                                |            |                    |                                |            |
| Loans and loans held for sale, net of unearned income         | \$797,090          | \$27,008                       | 4.49%      | \$736,896          | \$26,002                       | 4.67%      |
| Interest bearing deposits                                     | 6,904              | 3                              | 0.06       | 8,541              | 5                              | 0.09       |
| Short-term investment in money market funds                   | 2,635              | 6                              | 0.21       | 3,437              | 7                              | 0.26       |
| Federal funds sold  |                    |                                |            | 106                |                                | 0.04       |
| Investment securities AFS                                     | 139,548            | 2,688                          | 2.57       | 151,041            | 2,774                          | 2.45       |
| Investment securities HTM                                     | 19,103             | 410                            | 2.86       | 17,625             | 371                            | 2.81       |
| Total investment securities                                   | 158,651            | 3,098                          | 2.60       | 168,666            | 3,145                          | 2.49       |
| Total interest earning assets/<br>interest income             | 965,280            | 30,115                         | 4.15       | 917,646            | 29,159                         | 4.23       |
| Non-interest earning assets:                                  |                    |                                |            |                    |                                |            |
| Cash and due from banks                                       | 15,755             |                                |            | 16,720             |                                |            |
| Premises and equipment  | 13,273             |                                |            | 12,656             |                                |            |
| Other assets  | 69,635             |                                |            | 76,683             |                                |            |
| Allowance for loan losses                                     | (10,101 )          |                                |            | (11,571 )          |                                |            |
| <b>TOTAL ASSETS</b>   | <b>\$1,053,842</b> |                                |            | <b>\$1,012,134</b> |                                |            |
| Interest bearing liabilities:                                 |                    |                                |            |                    |                                |            |
| Interest bearing deposits:                                    |                    |                                |            |                    |                                |            |
| Interest bearing demand                                       | \$95,688           | \$140                          | 0.20%      | \$72,308           | \$99                           | 0.18%      |
| Savings   | 89,647             | 107                            | 0.16       | 88,128             | 104                            | 0.16       |
| Money markets   | 228,898            | 584                            | 0.34       | 210,993            | 549                            | 0.35       |
| Time deposits   | 301,959            | 2,857                          | 1.27       | 313,075            | 3,160                          | 1.35       |
| Total interest bearing deposits                               | 716,192            | 3,688                          | 0.69       | 684,504            | 3,912                          | 0.76       |
| Short-term borrowings   | 16,606             | 34                             | 0.26       | 13,590             | 25                             | 0.25       |
| Advances from Federal Home Loan Bank                          | 30,605             | 223                            | 0.97       | 16,537             | 100                            | 0.80       |
| Guaranteed junior subordinated deferrable interest debentures | 13,085             | 840                            | 8.57       | 13,085             | 840                            | 8.57       |
| Total interest bearing liabilities/<br>interest expense       | 776,488            | 4,785                          | 0.82       | 727,716            | 4,877                          | 0.90       |
| Non-interest bearing liabilities:                             |                    |                                |            |                    |                                |            |
| Demand deposits   | 153,648            |                                |            | 159,550            |                                |            |
| Other liabilities   | 8,395              |                                |            | 14,298             |                                |            |
| Shareholders equity   | 115,311            |                                |            | 110,570            |                                |            |
|   | <b>\$1,053,842</b> |                                |            | <b>\$1,012,134</b> |                                |            |

TOTAL LIABILITIES AND  
SHAREHOLDERS EQUITY

|   |          |       |          |       |
|---|----------|-------|----------|-------|
| Interest rate spread                    |          | 3.33  |          | 3.33  |
| Net interest income/Net interest margin | 25,330   | 3.48% | 24,282   | 3.52% |
| Tax-equivalent adjustment               | (18 )    |       | (19 )    |       |
| Net Interest Income                     | \$25,312 |       | \$24,263 |       |

38

---

TABLE OF CONTENTS

**.....PROVISION FOR LOAN LOSSES.....** For the nine month period during 2014, the Company did not record a provision for loan losses compared to a \$100,000 negative provision in the first nine months of 2013. Overall, sustained improvements in asset quality evidenced by low levels of non-performing assets and classified loans has allowed the Company to benefit from zero or negative loan loss provisions in both 2014 and 2013 while still maintaining strong coverage ratios. For the first nine months of 2014 actual credit losses realized through net charge-offs totaled \$522,000, or 0.09% of total loans, which represents a decrease from the first nine months of 2013 when net charge-offs totaled \$1.3 million, or 0.23% of total loans. The allowance for loan losses was 1.18% of total loans at September 30, 2014, compared to 1.29% of total loans at December 31, 2013.

**.....NON-INTEREST INCOME.....**Non-interest income for the first nine months of 2014 totaled \$10.8 million and decreased \$1.1 million, or 9.4%, from the first nine months 2013 performance. Factors contributing to this lower level of non-interest income for the period included:

reduced revenue from residential mortgage banking activities was caused by both lower refinance activity due to higher mortgage rates and reduced purchase activity due to the harsh winter weather conditions in the first quarter.

\* As a result, gains realized on residential mortgage loan sales into the secondary market declined by \$365,000, or 40.0%, and mortgage related fees dropped by \$174,000 due largely to lower mortgage origination and underwriting fees.

\* a \$272,000 decrease in other income due to a net unfavorable swing of \$136,000 on other real estate owned property transactions and lower financial services commission revenue in 2014.

\* a \$234,000 decrease in bank owned life insurance revenue due largely to the receipt of a death claim in the prior year.

**.....NON-INTEREST EXPENSE.....**Non-interest expense for the first nine months of 2014 totaled \$32.6 million and increased by \$1.1 million, or 3.6%, from the prior year's first nine months. Factors contributing to the higher non-interest expense in the period included:

professional fees increased by \$913,000 for the nine month period due to higher legal costs related to litigation against the former CEO of WCCA for violations of provisions in his employment agreement, the consulting costs associated with our profitability improvement project and new recurring costs related to outsourcing our computer operations and statement processing to a third party vendor. The overall cost savings benefit from outsourcing these services is captured in lower personnel costs in these departments and reduced software expense, which is a key factor contributing to the decline in other expenses of \$166,000 for the nine month period in 2014.

\* the previously discussed \$669,000 goodwill impairment charge at WCCA in 2014.

\* a \$217,000 decrease in miscellaneous taxes and insurance due to reduced Pennsylvania bank shares tax expense resulting from a change in the calculation methodology that took effect January 1, 2014.

**.....INCOME TAX EXPENSE.....**The Company recorded an income tax expense of \$1.2 million, or an effective tax rate of 34.5%, in the first nine months of 2014 compared to income tax expense of \$1.4 million, or an effective tax rate of 29.6%, for the first nine months of 2013. The higher effective tax rate in 2014 was primarily due to the non-deductibility of the goodwill impairment charge for tax purposes. This was the factor responsible for the unusually high effective tax rate of 51.5% for the third quarter of 2014 as the impact of the goodwill impairment charge was more pronounced on the quarterly results. The Company's deferred tax asset was \$8.8 million at September 30, 2014 and relates primarily to the allowance for loan losses and net operating loss carryforwards.

**.....SEGMENT RESULTS.....**Retail banking's net income contribution was \$706,000 in the third quarter and \$1.7 million for the first nine months of 2014 which was down by \$23,000 and \$668,000, respectively, from the net income contribution for the same 2013 periods. This decline in earnings in 2014 was due to the previously discussed decrease in residential mortgage banking related revenues, lower deposit service charges and reduced revenue from bank owned life insurance in 2014. Net interest income was also down in this segment reflecting the ongoing net interest

margin pressure from the continued low interest rate environment which causes the funding benefit for deposits provided by this segment to be lower.

TABLE OF CONTENTS

The commercial banking segment reported net income contributions of \$1.1 million in the third quarter and \$3.3 million for the first nine months of 2014 which were modestly better than the 2013 results for the same periods. This improved net income contribution was due to higher net interest income as a result of the previously discussed strong growth in commercial and commercial real estate loans over the past year. This growth in net interest income more than offset no earnings benefit from a negative loan loss provision, reduced non-interest revenue from a net \$64,000 loss realized on the sale of other real estate owned property and generally higher non-interest expenses in this segment in 2014. The higher non-interest expense was most evident in salaries and employee benefits as we have increased staffing levels within this segment to generate and support the solid commercial loan growth that we have achieved.

The trust segment reported a net loss of \$432,000 for the third quarter of 2014 and net income of \$232,000 for the first nine months of 2014. When compared to the same periods in 2013, this represents a \$742,000 decline for the quarter and a \$584,000 decline for the nine month period, respectively. Both 2014 periods were negatively impacted by the previously discussed \$669,000 goodwill impairment charge at WCCA due to the loss of certain clients and a reduction in the projected earnings capacity of WCCA. Non-interest revenue for this segment was also negatively impacted by client attrition at WCCA and lower financial services revenue due to fewer production personnel in 2014. However, non-interest expense in this segment (excluding the goodwill impairment charge) was also down due to reduced personnel cost at WCCA which has helped mitigate a significant portion of the revenue decline.

The investment/parent segment reported net losses of \$1.1 million in the third quarter and \$2.9 million for the first nine months of 2014 which was down by \$101,000 for the quarter comparison, but was still \$96,000 better compared to the same 2013 year to date period. The improvement between years for the nine month period reflects the benefit of reduced premium amortization on mortgage backed securities and increased gains realized on investment security sales in 2014. However, overall this segment has felt the most earnings pressure from the continued low interest rate environment.

.....**BALANCE SHEET**.....The Company's total consolidated assets were \$1.070 billion at September 30, 2014, which grew by \$14.4 million, or 1.4%, from the December 31, 2013 asset level. The growth in assets was due to a \$31.1 million, or 4.0%, increase in net loans during the first nine months of 2014. This loan increase was partially offset by a \$9.7 million decrease in investment securities and a \$7 million decline in cash and cash equivalents as the Company utilized these items to help fund the loan growth.

Total deposits increased by \$18 million, or 2.1%, in the first nine months of 2014. The Company used these deposits to fund loans. Total FHLB borrowings are down by \$3.1 million since year-end 2013 and there has also been a shift from short term borrowings to term advances. The FHLB term advances with maturities between 3 and 5 years grew by \$12 million and now total \$37 million as the Company has utilized these advances to help manage interest rate risk in a rising rate environment. The Company's total shareholders' equity increased by \$2.8 million over the first nine months of 2014 due to the Company's net retention of earnings after dividend payments and a reduction in accumulated other comprehensive loss. The Company continues to be considered well capitalized for regulatory purposes with a risk based capital ratio of 15.00%, and an asset leverage ratio of 11.44% at September 30, 2014. The Company's book value per common share was \$5.06, its tangible book value per common share was \$4.43, and its tangible common equity to tangible assets ratio was 7.86% at September 30, 2014.

TABLE OF CONTENTS

.....**LOAN QUALITY**.....The following table sets forth information concerning the Company's loan delinquency, non-performing assets, and classified assets (in thousands, except percentages):

|  | September<br>30,<br>2014 | December<br>31,<br>2013 | September<br>30,<br>2013 |
|--|--------------------------|-------------------------|--------------------------|
| Total accruing loan delinquency<br>(past due 30 to 89 days)  | \$2,256                  | \$3,264                 | \$3,882                  |
| Total non-accrual loans  | 3,001                    | 2,871                   | 3,259                    |
| Total non-performing assets including TDR*   | 3,898                    | 4,109                   | 5,037                    |
| Accruing loan delinquency, as a percentage of total loans,<br>net of unearned income                             | 0.28 %                   | 0.42 %                  | 0.51 %                   |
| Non-accrual loans, as a percentage of total loans, net<br>of unearned income                                     | 0.37                     | 0.37                    | 0.43                     |
| Non-performing assets, as a percentage of total<br>loans, net of unearned income, and other real<br>estate owned | 0.48                     | 0.52                    | 0.66                     |
| Non-performing assets as a percentage of total assets  | 0.36                     | 0.39                    | 0.49                     |
| As a percent of average loans, net of unearned income:   |                          |                         |                          |
| Annualized net charge-offs   | 0.09                     | 0.18                    | 0.23                     |
| Annualized provision (credit) for loan losses  |                          | (0.15 )                 | (0.02 )                  |
| Total classified loans (loans rated substandard or doubtful)   | \$12,053                 | \$11,779                | \$17,396                 |

Non-performing assets are comprised of (i) loans that are on a non-accrual basis, (ii) loans that are contractually past \*due 90 days or more as to interest and principal payments, (iii) performing loans classified as a troubled debt restructuring and (iv) other real estate owned.

The Company continued to maintain strong asset quality in the first nine months of 2014 as evidenced by low levels of non-accrual loans, non-performing assets, classified loans, and loan delinquency levels that continue to be well below 1% of total loans. We continue to closely monitor the loan portfolio given the slow recovery in the economy and the number of relatively large-sized commercial and commercial real estate loans within the portfolio. As of September 30, 2014, the 25 largest credits represented 26.5% of total loans outstanding.

.....**ALLOWANCE FOR LOAN LOSSES**.....The following table sets forth the allowance for loan losses and certain ratios for the periods ended (in thousands, except percentages):

|   | September<br>30,<br>2014 | December<br>31,<br>2013 | September<br>30,<br>2013 |
|---|--------------------------|-------------------------|--------------------------|
| Allowance for loan losses   | \$9,582                  | \$10,104                | \$11,183                 |
| Allowance for loan losses as a percentage of each of the<br>following total loans, net of unearned income | 1.18 %                   | 1.29 %                  | 1.47 %                   |
| total accruing delinquent loans<br>(past due 30 to 89 days)   | 424.73                   | 309.56                  | 288.07                   |
| total non-accrual loans   | 298.13                   | 351.93                  | 343.14                   |
| total non-performing assets   | 245.82                   | 245.90                  | 222.02                   |

The Company recorded no loan loss provision in the first nine months of 2014 and reversed a small portion of the allowance for loan losses into earnings during the same period in 2013 due to the previously discussed sustained improvement in asset quality. The Company did experience a relatively low level of net charge-offs in the first nine months of 2014. As a result, the balance in the allowance for loan losses has declined modestly in the first nine months of 2014 while the Company has been able to still maintain strong coverage of non-accrual loans and non-performing assets as indicated in the above table.

TABLE OF CONTENTS

.....**LIQUIDITY**.....The Company's liquidity position has been strong during the last several years. Our core retail deposit base has grown over the past five years and has been more than adequate to fund the Company's operations. Cash flow from maturities, prepayments and amortization of securities was also used to help fund loan growth over the past few years. We strive to operate our loan to deposit ratio in a range of 85% to 100%. At September 30, 2014, the Company's loan to deposit ratio was 93.3%. We are optimistic that we can increase the loan to deposit ratio in the future given current commercial loan pipelines, continued growth of our loan production offices and our focus on small business lending.

Liquidity can be analyzed by utilizing the Consolidated Statement of Cash Flows. Cash and cash equivalents decreased by \$6.6 million from December 31, 2013 to September 30, 2014, due to \$22.6 million of cash used in investing activities. This more than offset the \$2.1 million of cash provided by operating activities and \$14.0 million of cash provided by financing activities. Within investing activities, cash provided from investment security maturities and sales was higher than cash used for new investment security purchases by \$10.3 million. Cash advanced for new loan fundings and purchases (excluding residential mortgages sold in the secondary market) totaled \$131.1 million and was \$31.4 million higher than the \$99.7 million of cash received from loan principal payments and participations. Within financing activities, deposit growth provided \$17.8 million of cash. Total borrowings decreased as paydowns of short-term advances exceeded purchases of FHLB term advances by \$3.1 million. At September 30, 2014, the Company had immediately available \$348 million of overnight borrowing capacity at the FHLB and \$39 million of unsecured federal funds lines with correspondent banks.

The holding company had \$15.8 million of cash, short-term investments, and investment securities at September 30, 2014. Additionally, dividend payments from our subsidiaries can also provide ongoing cash to the holding company. At September 30, 2014, our subsidiary Bank had \$1.2 million of cash available for immediate dividends to the holding company under applicable regulatory formulas. Overall, the holding company has strong liquidity to meet its trust preferred debt service requirements and preferred stock dividends, which should approximate \$1.2 million over the next twelve months. Additionally, the Company has ample cash to provide for its \$0.01 per share quarterly common stock cash dividend, which will require \$187,000 of cash on a quarterly basis. The most recent \$0.01 dividend was announced on October 17, 2014 payable on November 17, 2014 to shareholders of record on November 3, 2014.

.....**CAPITAL RESOURCES**.....The Company meaningfully exceeds all regulatory capital ratios for each of the periods presented and is considered well capitalized. The asset leverage ratio was 11.44% and the risk based capital ratio was 15.00% at September 30, 2014. The Company's tangible common equity to tangible assets ratio was 7.86% at September 30, 2014. We anticipate that we will maintain our strong capital ratios throughout the remainder of 2014. Capital generated from earnings will be utilized to pay the SBLF preferred dividend, common stock cash dividend and will also support anticipated balance sheet growth. Our common dividend payout ratio for the first nine months of 2014 was 27.3%.

On July 2, 2013, the Board of Governors of the Federal Reserve System approved final rules that substantially amend the regulatory risk-based capital rules applicable to the Company and the Bank. The final rules implement the Basel III regulatory capital reforms, as well as certain changes required by the Dodd-Frank Act. The July 2013 final rules generally implement higher minimum capital requirements, add a new common equity tier 1 capital requirement, and establish criteria that instruments must meet to be considered common equity tier 1 capital, additional tier 1 capital or tier 2 capital. The new minimum capital to risk-adjusted assets requirements are a common equity tier 1 capital ratio of 4.5% (6.5% to be considered well capitalized) and a tier 1 capital ratio of 6.0%, increased from 4.0% (and increased from 6.0% to 8.0% to be considered well capitalized); the total capital ratio remains at 8.0% under the new rules (10.0% to be considered well capitalized). Under the new rules, in order to avoid limitations on capital distributions (including dividend payments and certain discretionary bonus payments to executive officers), a banking organization must hold a capital conservation buffer comprised of common equity tier 1 capital above its minimum risk-based



capital requirements in an amount greater than 2.5% of total risk-weighted assets. The new minimum capital requirements are effective for the Company and the Bank on January 1, 2015. The capital contribution buffer requirements phase in over a three-year period beginning January 1, 2016.

TABLE OF CONTENTS

The July 2013 final rules include three significant changes from the proposals initially made by federal banking regulators in September 2012: (i) the final rules do not change the current risk weighting for residential mortgage exposures; (ii) the final rules permit institutions, other than certain large institutions, to elect to continue to treat certain components of accumulated other comprehensive income as permitted under the current general risk-based capital rules, and not reflect unrealized gains and losses on available-for-sale securities in common equity tier 1 calculations; and (iii) the final rules permit institutions with less than \$15.0 billion in assets to grandfather certain non-qualifying capital instruments (including trust preferred securities) issued prior to May 19, 2009 into tier 1 capital.

The Company is continuing to review the impact of these new rules and currently expects that its capital position will be more than adequate to meet the revised regulatory capital requirements upon their implementation.

**.....INTEREST RATE SENSITIVITY.....**The following table presents an analysis of the sensitivity inherent in the Company's net interest income and market value of portfolio equity. The interest rate scenarios in the table compare the Company's base forecast, which was prepared using a flat interest rate scenario, to scenarios that reflect immediate interest rate changes of 100 and 200 basis points. Note that we suspended the 200 basis point downward rate shock since it has little value due to the absolute low level of interest rates. Each rate scenario contains unique prepayment and repricing assumptions that are applied to the Company's existing balance sheet that was developed under the flat interest rate scenario.

| Interest Rate Scenario | Variability of Net Interest Income |   | Change in Market Value of Portfolio Equity |   |
|------------------------|------------------------------------|---|--|---|
| 200bp increase         | 1.1                                | % | 8.1  | % |
| 100bp increase         | 1.0                                |   | 5.7  |   |
| 100bp decrease         | (3.8                               | ) | (14.8                                      | ) |

The Company believes that its overall interest rate risk position is well controlled. The variability of net interest income is modestly positive in the upward rate shocks due to the Company's short duration investment securities portfolio and scheduled repricing of loans tied to LIBOR or prime. Also, the Company expects that it will not have to reprice its core deposit accounts up as quickly when interest rates rise. The variability of net interest income is negative in the 100 basis point downward rate scenario as the Company has more exposure to assets repricing downward to a greater extent than liabilities due to the absolute low level of interest rates with the fed funds rate currently at 0.25%. The market value of portfolio equity increases in the upward rate shocks due to the improved value of the Company's core deposit base. Negative variability of market value of portfolio equity occurs in the downward rate shock due to a reduced value for core deposits.

**.....OFF BALANCE SHEET ARRANGEMENTS.....**The Company incurs off-balance sheet risks in the normal course of business in order to meet the financing needs of its customers. These risks derive from commitments to extend credit and standby letters of credit. Such commitments and standby letters of credit involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated financial statements. The Company had various outstanding commitments to extend credit approximating \$172.1 million and standby letters of credit of \$12.1 million as of September 30, 2014. The Company's exposure to credit loss in the event of nonperformance by the other party to these commitments to extend credit and standby letters of credit is represented by their contractual amounts. The Company uses the same credit and collateral policies in making commitments and conditional obligations as for all other lending.

**.....CRITICAL ACCOUNTING POLICIES AND ESTIMATES.....**The accounting and reporting policies of the Company are in accordance with Generally Accepted Accounting Principles and conform to general practices within the banking industry. Accounting and reporting policies for the allowance for loan losses, goodwill, income taxes, and investment securities are deemed critical because they involve the use of estimates and require significant management judgments. Application of assumptions different than those used by the Company could result in material changes in the Company's financial position or results of operation.

| <b>ACCOUNT</b>                    | <b>Allowance for Loan Losses</b>          |
|-----------------------------------|---|
| <b>BALANCE SHEET REFERENCE</b>    | <b>Allowance for loan losses</b>          |
| <b>INCOME STATEMENT REFERENCE</b> | <b>Provision (credit) for loan losses</b> |
|                                   | <b>DESCRIPTION</b>                        |

TABLE OF CONTENTS

The allowance for loan losses is calculated with the objective of maintaining reserve levels believed by management to be sufficient to absorb estimated probable credit losses. Management's determination of the adequacy of the allowance is based on periodic evaluations of the credit portfolio and other relevant factors. However, this quarterly evaluation is inherently subjective as it requires material estimates, including, among others, likelihood of customer default, loss given default, exposure at default, the amounts and timing of expected future cash flows on impaired loans, value of collateral, estimated losses on consumer loans and residential mortgages, and general amounts for historical loss experience. This process also considers economic conditions, uncertainties in estimating losses and inherent risks in the various credit portfolios. All of these factors may be susceptible to significant change. Also, the allocation of the allowance for credit losses to specific loan pools is based on historical loss trends and management's judgment concerning those trends.

Commercial and commercial real estate loans are the largest category of credits and the most sensitive to changes in assumptions and judgments underlying the determination of the allowance for loan loss. Approximately \$7.2 million, or 75%, of the total allowance for loan losses at September 30, 2014 has been allocated to these two loan categories.

This allocation also considers other relevant factors such as actual versus estimated losses, economic trends, delinquencies, levels of non-performing and TDR loans, 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. To the extent actual outcomes differ from management estimates, additional provision for loan losses may be required that would adversely impact earnings in future periods.

**ACCOUNT      Goodwill**  
**BALANCE SHEET REFERENCE      Goodwill**  
**INCOME STATEMENT REFERENCE      Goodwill impairment**  
**DESCRIPTION**

The Company considers our accounting policies related to goodwill to be critical because the assumptions or judgment used in determining the fair value of assets and liabilities acquired in past acquisitions are subjective and complex. As a result, changes in these assumptions or judgment could have a significant impact on our financial condition or results of operations.

The fair value of acquired assets and liabilities, including the resulting goodwill, was based either on quoted market prices or provided by other third party sources, when available. When third party information was not available, estimates were made in good faith by management primarily through the use of internal cash flow modeling techniques. The assumptions that were used in the cash flow modeling were subjective and are susceptible to significant changes. The Company routinely utilizes the services of an independent third party that is regarded within the banking industry as an expert in valuing core deposits to monitor the ongoing value and changes in the Company's core deposit base. These core deposit valuation updates are based upon specific data provided from statistical analysis of the Company's own deposit behavior to estimate the duration of these non-maturity deposits combined with market interest rates and other economic factors.

Goodwill arising from business combinations represents the value attributable to unidentifiable intangible elements in the business acquired. The Company's goodwill relates to value inherent in the banking and wealth management businesses, and the value is dependent upon the Company's ability to provide quality, cost-effective services in the face of free competition from other market participants on a regional basis. This ability relies upon continuing investments in processing systems, the development of value-added service features and the ease of use of the Company's services. As such, goodwill value is supported ultimately by revenue that is driven by the volume of business transacted and the loyalty of the Company's deposit and customer base over a longer time frame. The quality and value of a Company's assets is also an important factor to consider when performing goodwill impairment testing.

A decline in earnings as a result of a lack of growth or the inability to deliver cost-effective value added services over sustained periods can lead to impairment of goodwill.

Goodwill which has an indefinite useful life is tested for impairment at least annually and written down and charged to results of operations only in periods in which the recorded value is more than the estimated fair value.

44

---

TABLE OF CONTENTS

The Company recorded a \$669,000 impairment charge as a result of a goodwill impairment analysis performed in the third quarter of 2014. A qualitative assessment of WCCA indicated that it was more likely than not that the carrying value of WCCA exceeded its fair value. As such, the Company then performed the necessary two-step impairment test. In Step 1, we determined the carrying value of WCCA, including the goodwill, and compared it to the estimated fair value of WCCA. The results of Step 1 indicated that the carrying value of the goodwill exceeded the fair value so it was necessary to move to Step 2 where we measured the amount of the impairment loss. After performing Step 2, we determined that the implied value of the goodwill was less than its carrying costs which caused us to record an impairment charge of \$669,000 in the third quarter of 2014. Overall, the voluntary departure of WCCA's former CEO and the related litigation against him for violations of his employment agreement, caused disruption within the WCCA customer base during 2014. This disruption ultimately led to the loss of certain clients and a reduction in the projected earnings capacity of WCCA. These were the key facts and circumstances that led to the goodwill impairment charge in the third quarter of 2014. The Company utilized a discounted cash flow model along with a valuation technique based upon a multiple of revenues to estimate the fair value of WCCA.

|                                   |   |
|-----------------------------------|---|
| <b>ACCOUNT</b>                    | <b>Income Taxes</b>                     |
| <b>BALANCE SHEET REFERENCE</b>    | <b>Net deferred tax asset</b>           |
| <b>INCOME STATEMENT REFERENCE</b> | <b>Provision for income tax expense</b> |
|                                   | <b>DESCRIPTION</b>                      |

The provision for income taxes is the sum of income taxes both currently payable and deferred. The changes in deferred tax assets and liabilities are determined based upon the changes in differences between the basis of assets and liabilities for financial reporting purposes and the basis of assets and liabilities as measured by the enacted tax rates that management estimates will be in effect when the differences reverse. This income tax review is completed on a quarterly basis.

In relation to recording the provision for income taxes, management must estimate the future tax rates applicable to the reversal of tax differences, make certain assumptions regarding whether tax differences are permanent or temporary and the related timing of the expected reversal. Also, estimates are made as to whether taxable operating income in future periods will be sufficient to fully recognize any gross deferred tax assets. If recovery is not likely, we must increase our provision for taxes by recording a valuation allowance against the deferred tax assets that we estimate will not ultimately be recoverable. Alternatively, we may make estimates about the potential usage of deferred tax assets that decrease our valuation allowances. As of September 30, 2014, we believe that all of the deferred tax assets recorded on our balance sheet will ultimately be recovered and that no valuation allowances were needed.

In addition, the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations. We recognize liabilities for anticipated tax audit issues based on our estimate of whether, and the extent to which, additional taxes will be due. If we ultimately determine that payment of these amounts is unnecessary, we reverse the liability and recognize a tax benefit during the period in which we determine that the liability is no longer necessary. We record an additional charge in our provision for taxes in the period in which we determine that the recorded tax liability is less than we expect the ultimate assessment to be.

|                                   |   |
|-----------------------------------|---|
| <b>ACCOUNT</b>                    | <b>Investment Securities</b>                                |
| <b>BALANCE SHEET REFERENCE</b>    | <b>Investment securities</b>                                |
| <b>INCOME STATEMENT REFERENCE</b> | <b>Net realized gains (losses) on investment securities</b> |
|                                   | <b>DESCRIPTION</b>  |

Available-for-sale and held-to-maturity securities are reviewed quarterly for possible other-than-temporary impairment. The review includes an analysis of the facts and circumstances of each individual investment such as the severity of loss, the length of time the fair value has been below cost, the expectation for that security's performance, the creditworthiness of the issuer and the Company's intent and ability to hold the security to recovery. A decline in value that is considered to be other-than-temporary is recorded as a loss within non-interest income in the Consolidated Statements of Operations. At September 30, 2014, the unrealized losses in the available-for-sale security portfolio were comprised of securities issued by government agencies or government sponsored agencies and certain high quality corporate securities. The Company

TABLE OF CONTENTS

believes 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. 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.

**.....FORWARD LOOKING STATEMENT.....**

**THE STRATEGIC FOCUS:**

The challenge for the future is to improve earnings performance to peer levels through a disciplined focus on community banking and improving the profitability of our Trust Company. In accordance with our strategic plan, AmeriServ will maintain its focus as a community bank delivering banking and trust services to the best of our ability and focus on further growing revenues by leveraging our strong capital base and infrastructure. This Company will not succumb to the lure of quick fixes and fancy financial gimmicks. It is our plan to continue to build AmeriServ into a potent banking force in this region and in this industry. Our focus encompasses the following:

**Customer Service** It is the existing and prospective customer that AmeriServ must satisfy. This means good products and fair prices. But it also means quick response time and professional competence. It means speedy problem resolution and a minimizing of bureaucratic frustrations. AmeriServ is training and motivating its staff to meet these standards while providing customers with more banking options that involve leading technologies such as computers, smartphones, and tablets to conduct business.

**Revenue Growth** It is necessary for AmeriServ to focus on growing revenues. This means loan growth, deposit growth and fee growth. It also means close coordination between all customer service areas so as many revenue producing products as possible can be presented to existing and prospective customers. The Company's Strategic Plan contains action plans in each of these areas particularly on increasing loans through several loan production offices. There will be a particular focus on small business commercial lending. An examination of the peer bank database provides ample proof that a well-executed community banking business model can generate a reliable and rewarding revenue stream.

**Expense Rationalization** AmeriServ Financial, Inc. remains focused on trying to rationalize expenses. This has not been a program of broad based cuts, but has been targeted so AmeriServ stays strong but spends less. The Company is implementing approximately \$1 million of non-interest expense savings for 2014. It is critical to be certain that future expenditures are directed to areas that are playing a positive role in the drive to improve revenues.

Additionally, the Company recently incurred approximately \$150,000 of expenses related to a profitability improvement project. The Company engaged a consulting firm that specializes in the areas of expense rationalization and profit improvement for community banks. This firm completed a thorough analysis of our business operations and practices during the third quarter. As a result of this project, the firm provided the Company with recommendations to reduce expenses and improve future profitability that we will evaluate and prioritize for implementation beginning in the fourth quarter of 2014 and continuing into 2015. The Company expects that its payback on this project will be significant.

This Form 10-Q contains various forward-looking statements and includes assumptions concerning the Company's beliefs, plans, objectives, goals, expectations, anticipations, estimates, intentions, operations, future results, and prospects, including statements that include the words may, could, should, would, believe, expect, anticipate, intend, project, plan or similar expressions. These forward-looking statements are based upon current expectations, and



subject to risk and uncertainties and are applicable only as of the dates of such statements. Forward-looking statements involve risks, uncertainties and assumptions. Although we do not make forward-looking statements unless we believe we have a reasonable basis for doing so, we cannot guarantee their accuracy. You should not put undue reliance on

TABLE OF CONTENTS

any forward-looking statements. These statements speak only as of the date of this Form 10-Q, even if subsequently made available on our website or otherwise, and we undertake no obligation to update or revise these statements to reflect events or circumstances occurring after the date of this Form 10-Q. In connection with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, the Company provides the following cautionary statement identifying important factors (some of which are beyond the Company's control) which could cause the actual results or events to differ materially from those set forth in or implied by the forward-looking statements and related assumptions.

Such factors include the following: (i) the effect of changing regional and national economic conditions; (ii) the effects of trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System; (iii) significant changes in interest rates and prepayment speeds; (iv) inflation, stock and bond market, and monetary fluctuations; (v) credit risks of commercial, real estate, consumer, and other lending activities; (vi) changes in federal and state banking and financial services laws and regulations; (vii) the presence in the Company's market area of competitors with greater financial resources than the Company; (viii) the timely development of competitive new products and services by the Company and the acceptance of those products and services by customers and regulators (when required); (ix) the willingness of customers to substitute competitors products and services for those of the Company and vice versa; (x) changes in consumer spending and savings habits; (xi) unanticipated regulatory or judicial proceedings; and (xii) other external developments which could materially impact the Company's operational and financial performance.

The foregoing list of important factors is not exclusive, and neither such list nor any forward-looking statement takes into account the impact that any future acquisition may have on the Company and on any such forward-looking statement.

**Item 3.....QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK.....**The Company manages market risk, which for the Company is primarily interest rate risk, through its asset liability management process and committee, see further discussion in Interest Rate Sensitivity section of the M.D. & A.

**Item 4.....CONTROLS AND PROCEDURES.....**(a) Evaluation of Disclosure Controls and Procedures. The Company's management carried out an evaluation, under the supervision and with the participation of the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and the operation of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of September 30, 2014, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer along with the Chief Financial Officer concluded that the Company's disclosure controls and procedures as of September 30, 2014, are effective.

(b) Changes in Internal Controls. There have been no changes in AmeriServ Financial Inc.'s internal controls over financial reporting that occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

TABLE OF CONTENTS

## **Part II Other Information**

### **Item 1. Legal Proceedings**

There are no material proceedings to which the Company or any of our subsidiaries are a party or by which, to the Company's knowledge, we, or any of our subsidiaries, are threatened. All legal proceedings presently pending or threatened against the Company or our subsidiaries involve routine litigation incidental to our business or that of the subsidiary involved and are not material in respect to the amount in controversy.

### **Item 1A. Risk Factors**

Not Applicable

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None

### **Item 3. Defaults Upon Senior Securities**

None

### **Item 4. Mine Safety Disclosures**

None

### **Item 5. Other Information**

None

### **Item 6. Exhibits**

- 3.1 Amended and Restated Articles of Incorporation as amended through August 11, 2011, exhibit 3.1 to the Registration Statement on Form S-8 (File No. 333-176869) filed on September 16, 2011.
- 3.2 Bylaws, as amended and restated on May 16, 2013, Exhibit 3.2 to the Form 8-K (File No. 000-11204) filed on May 22, 2013.
- 15.1 Report of S.R. Snodgrass, P.C. regarding unaudited interim financial statement information.
- 15.2 Awareness Letter of S.R. Snodgrass, P.C.
- 31.1 Certification pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

101 The following information from AMERISERV FINANCIAL, INC. s Quarterly Report on Form 10-Q for the quarter ended September 30, 2014, formatted in XBRL (eTensible Business Reporting Language): (i) Consolidated Balance Sheets (unaudited), (ii) Consolidated Statements of Operations (unaudited), (iii) Consolidated Statements of Comprehensive Income (unaudited), (iv) Consolidated Statements of Cash Flows (unaudited), and (iv) Notes to the Unaudited Consolidated Financial Statements.

TABLE OF CONTENTS

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

AmeriServ Financial, Inc.

Registrant

/s/ Glenn L. Wilson

Date: November 7, 2014

Glenn L. Wilson

President and Chief Executive Officer

/s/ Jeffrey A. Stopko

Date: November 7, 2014

Jeffrey A. Stopko

Executive Vice President and Chief Financial Officer