

CNB FINANCIAL CORP/PA  
Form 10-K  
March 08, 2013  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
**FORM 10 K**  
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2012

For the fiscal year ended December 31, 2012

Commission File Number 0-13396

**CNB FINANCIAL CORPORATION**

(Exact name of registrant as specified in its charter)

Pennsylvania  
(State or other jurisdiction of  
incorporation or organization)

25-1450605  
(I.R.S. Employer Identification No.)

1 South Second Street

P.O. Box 42

Clearfield, Pennsylvania 16830

(Address of principal executive office)

Registrant's telephone number, including area code (814) 765-9621

Securities registered pursuant to Section 12(b) of the Act:

| <b>Title of each class</b>           | <b>Name of each exchange on which registered</b>             |
|--------------------------------------|--|
| Common Stock, no par value per share | The NASDAQ Stock Market LLC<br>(NASDAQ Global Select Market) |

Securities registered pursuant to Section 12 (g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes  No

Aggregate market value of the common stock held by non-affiliates of the registrant as of June 30, 2012:

\$190,857,076

The number of shares outstanding of the registrant's common stock as of March 4, 2013:

12,508,403 shares

### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the proxy statement for the annual shareholders' meeting to be held on April 16, 2013 are incorporated by reference into Part III.

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**PART I.**

**ITEM 1. BUSINESS**

CNB Financial Corporation (the Corporation) is a financial holding company registered under the Bank Holding Company Act of 1956, as amended. It was incorporated under the laws of the Commonwealth of Pennsylvania in 1983 for the purpose of engaging in the business of a financial holding company. On April 26, 1984, the Corporation acquired all of the outstanding capital stock of County National Bank, a national banking chartered institution. In December 2006, County National Bank changed its name to CNB Bank, referred to herein as the Bank, and became a state bank chartered in Pennsylvania and subject to regulation by the Pennsylvania Department of Banking and the Federal Deposit Insurance Corporation.

In addition to the Bank, the Corporation has four other subsidiaries. CNB Securities Corporation is incorporated in Delaware and currently maintains investments in debt and equity securities. County Reinsurance Company is an Arizona corporation and provides credit life and disability insurance for customers of CNB Bank. CNB Insurance Agency, incorporated in Pennsylvania, provides for the sale of nonproprietary annuities and other insurance products. Holiday Financial Services Corporation, incorporated in Pennsylvania, offers small balance unsecured loans and secured loans, primarily collateralized by automobiles and equipment, to borrowers with higher risk characteristics.

**CNB Bank**

CNB Bank (the Bank) was incorporated in 1934 and is chartered in the Commonwealth of Pennsylvania. ERIEBANK, a division of CNB Bank, began operations in 2005. The Bank has 28 full service branch offices and one loan production office located in various communities in its market area. The Bank's primary market area consists of the Pennsylvania counties of Cambria, Cameron, Clearfield, Crawford Elk, Erie, Indiana, McKean and Warren. It also includes a portion of western Centre County including Philipsburg Borough, Rush Township and the western portions of Snow Shoe and Burnside Townships and a portion of Jefferson County, consisting of the boroughs of Brockway, Falls Creek, Punxsutawney, Reynoldsville and Sykesville, and the townships of Washington, Winslow and Henderson.

The Bank is a full service bank engaging in a full range of banking activities and services for individual, business, governmental and institutional customers. These activities and services principally include checking, savings, and time deposit accounts; real estate, commercial, industrial, residential and consumer loans; and a variety of other specialized financial services. The Bank's Wealth & Asset Management Services division offers a full range of client services.

**Holiday Financial Services Corporation**

In 2005, the Corporation entered the consumer discount loan and finance business, which is conducted through a wholly owned subsidiary, Holiday Financial Services Corporation. Holiday currently has ten offices within the Corporation's footprint. Management believes that it has made the necessary investments in experienced personnel and technology which has helped facilitate the growth of Holiday into a successful and profitable subsidiary.

**Competition**

The financial services industry in the Corporation's service area continues to be extremely competitive, both among commercial banks and with other financial service providers such as consumer finance

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companies, thrifts, investment firms, mutual funds and credit unions. The increased competition has resulted from changes in the legal and regulatory guidelines as well as from economic conditions. Mortgage banking firms, leasing companies, financial affiliates of industrial companies, brokerage firms, retirement fund management firms, and even government agencies provide additional competition for loans and other financial services. Some of the financial service providers operating in the Corporation's market area operate on a large-scale regional or national basis and possess resources greater than those of the Corporation. The Corporation is generally competitive with all competing financial institutions in its service area with respect to interest rates paid on time and savings deposits, service charges on deposit accounts and interest rates charged on loans.

## **Supervision and Regulation**

The Corporation is a bank holding company and a financial holding company and the Bank is a Pennsylvania state-chartered bank that is not a member of the Board of Governors of the Federal Reserve System (Federal Reserve Board). Accordingly, the Corporation is subject to the oversight of the Federal Reserve Board and the Pennsylvania Department of Banking, and the Bank is subject to the oversight of applicable federal and state banking agencies, including the Pennsylvania Department of Banking and Federal Deposit Insurance Corporation (FDIC). The Corporation and Bank are also subject to various requirements and restrictions under federal and state law, such as requirements to maintain reserves against deposits, restrictions on the types, amounts and terms and conditions of loans that may be granted, and limitations on the types of investments that may be made and the types of services that may be offered. Various consumer protection laws and regulations also affect the operation of the Bank and, pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the Bureau of Consumer Financial Protection is authorized to write rules on consumer financial products which could affect the operations of the Bank. In addition to the impact of regulation, commercial banks are affected significantly by the actions of the Federal Reserve Board, including actions taken with respect to interest rates, as the Federal Reserve Board attempts to control the money supply and credit availability in the U.S. in order to influence the economy.

The following summary sets forth certain of the material elements of the regulatory framework applicable to bank holding companies and their subsidiaries and provides certain specific information about us and our subsidiaries. It does not describe all of the provisions of the statutes, regulations and policies that are identified. To the extent that the following information describes statutory and regulatory provisions, it is qualified in its entirety by express reference to each of the particular statutory and regulatory provisions. A change in applicable statutes, regulations or regulatory policy may have a material effect on our business.

### *Bank Holding Company Regulation*

As a bank holding company, the Corporation is subject to regulation and examination by the Pennsylvania Department of Banking and the Federal Reserve Board. We are required to file with the Federal Reserve Board an annual report and such additional information as the Federal Reserve Board may require pursuant to the Bank Holding Company Act of 1956, as amended (the BHC Act), and applicable regulations. For instance, the BHC Act requires each bank holding company to obtain the approval of the Federal Reserve Board before it may acquire substantially all the assets of any bank, or before it may acquire ownership or control of any voting shares of any bank if, after such acquisition, it would own or control, directly or indirectly, more than five percent of any class of voting shares of such bank. Such a transaction may also require approval of the Pennsylvania Department of Banking.

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Pursuant to provisions of the BHC Act and regulations promulgated by the Federal Reserve Board thereunder, the Corporation may only engage in, or own companies that engage in, activities deemed by the Federal Reserve Board to be permissible for bank holding companies or financial holding companies. Activities permissible for bank holding companies are those that are so closely related to the business of banking or managing or controlling banks as to be a proper incident thereto. Permissible activities for financial holding companies include those so closely related to banking as well as certain additional activities deemed financial in nature. The Corporation must obtain permission from or provide notice to the Federal Reserve Board prior to engaging in most new business activities.

Under Federal Reserve Board regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, it is the Federal Reserve Board's policy that in serving as a source of strength to its subsidiary banks, a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve Board to be an unsafe and unsound banking practice or a violation of the Federal Reserve Board regulations or both. This doctrine is commonly known as the source of strength doctrine.

The Federal Reserve has adopted risk-based capital guidelines for bank holding companies. Currently, the required minimum ratio of total capital to risk-weighted assets (including off-balance sheet activities, such as standby letters of credit) is 8%. At least half of the total capital is required to be Tier 1 capital, consisting principally of common shareholders' equity, non-cumulative perpetual preferred stock, a limited amount of cumulative perpetual preferred stock and minority interests in the equity accounts of consolidated subsidiaries, less goodwill. The remainder (Tier 2 capital) may consist of a limited amount of subordinated debt and intermediate-term preferred stock, certain hybrid capital instruments and other debt securities, perpetual preferred stock and a limited amount of the general loan loss allowance.

In addition to the risk-based capital guidelines, the Federal Reserve has established minimum leverage ratio (Tier 1 capital to total assets) guidelines for bank holding companies. These guidelines provide for a minimum leverage ratio of 3% for those bank holding companies which have the highest regulatory examination ratings and are not contemplating or experiencing significant growth or expansion. All other bank holding companies are required to maintain a leverage ratio of at least 4%.

### *Regulation of CNB Bank*

CNB Bank is a Pennsylvania-chartered bank and is subject to regulation, supervision and regular examination by the Pennsylvania Department of Banking and the FDIC. Federal and state banking laws and regulations govern, among other things, the scope of a bank's business, the investments a bank may make, the reserves against deposits a bank must maintain, the loans a bank makes and collateral it takes, the activities of a bank with respect to mergers and acquisitions, the establishment of branches, management practices, and numerous other aspects of banking operations.

### *Recent Legislation*

The Dodd-Frank Act, enacted into law on July 21, 2010, includes numerous provisions designed to strengthen the financial industry, enhance consumer protection, expand disclosures and provide for

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transparency, and significantly changed the bank regulatory structure and affected and will continue to affect the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act also created a Consumer Financial Protection Bureau ( CFPB ), which is authorized to write rules on a number of consumer financial products, and a Financial Services Oversight Council, which is empowered to determine which entities are systematically significant and require tougher regulations.

The Dodd-Frank Act requires various federal agencies to adopt a broad range of new rules and regulations, and to prepare various studies and reports for Congress.

It is difficult to predict at this time what specific impact certain provisions of the Dodd-Frank Act and the implementing rules and regulations, many which have yet to be written, will have on the Corporation, including any regulations promulgated by the CFPB. The legislation and any implementing rules that are ultimately issued could have adverse implications on the financial industry, the competitive environment, and the Corporation's ability to conduct business. The Corporation will have to apply resources to ensure that it is in compliance with all applicable provisions of the Dodd-Frank Act and any implementing rules, which may increase its costs of operations and adversely impact its earnings.

### *Dividend Restrictions*

The Corporation is a legal entity separate and distinct from the Bank. Declaration and payment of cash dividends depends upon cash dividend payments to the Corporation by the Bank, which is our primary source of revenue and cash flow. Accordingly, the right of the Corporation, and consequently the right of our creditors and shareholders, to participate in any distribution of the assets or earnings of any subsidiary is necessarily subject to the prior claims of creditors of the subsidiary, except to the extent that claims of the Corporation in its capacity as a creditor may be recognized.

As a Pennsylvania state-chartered bank, the Bank is subject to regulatory restrictions on the payment and amounts of dividends under the Pennsylvania Banking Code. Further, the ability of banking subsidiaries to pay dividends is also subject to their profitability, financial condition, capital expenditures and other cash flow requirements.

The payment of dividends by the Bank and the Corporation may also be affected by other factors, such as the requirement to maintain adequate capital above regulatory guidelines. The federal banking agencies have indicated that paying dividends that deplete a depository institution's capital base to an inadequate level would be an unsafe and unsound banking practice. A depository institution may not pay any dividend if payment would cause it to become undercapitalized or if it already is undercapitalized. Moreover, the federal agencies have issued policy statements that provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings. Federal banking regulators have the authority to prohibit banks and bank holding companies from paying a dividend if the regulators deem such payment to be an unsafe or unsound practice.

### *Capital Adequacy and Operations*

Under applicable prompt corrective action ( PCA ) statutes and regulations, depository institutions are placed into one of five capital categories, ranging from well capitalized to critically undercapitalized. The FDIC, in the case of the Bank, is required to take certain, and is authorized to take other, supervisory action against a depository institution that falls below certain of these levels.

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The PCA statute and regulations provide for progressively more stringent supervisory measures as a depository institution's capital category declines. An institution that is not well capitalized is generally prohibited from accepting brokered deposits and offering interest rates on deposits higher than the prevailing rate in its market. An undercapitalized depository institution must submit an acceptable capital restoration plan to the appropriate federal bank regulatory agency. One requisite element of such a plan is that the institution's parent holding company must guarantee compliance by the institution with the plan, subject to certain limitations.

At December 31, 2012, the Bank qualified as well capitalized under applicable regulatory capital standards.

### *Community Reinvestment Act*

Under the Community Reinvestment Act of 1977 (CRA), the FDIC is required to assess the record of all financial institutions regulated by it to determine if these institutions are meeting the credit needs of the community (including low and moderate income neighborhoods) which they serve. CRA performance evaluations are based on a four-tiered rating system: Outstanding, Satisfactory, Needs to Improve and Substantial Noncompliance. CRA performance evaluations are considered in evaluating applications for such things as mergers, acquisitions and applications to open branches. The Bank received a CRA rating of Satisfactory at its most current CRA exam.

### *Restrictions on Transactions with Affiliates and Insiders*

The Bank and Corporation also are subject to the restrictions of Sections 23A and 23B of the Federal Reserve Act, and their implementing Regulation W, issued by the Federal Reserve Board. Section 23A requires that loans or extensions of credit by the Bank to an affiliate, purchases of securities by the Bank issued by an affiliate, purchases of assets by the Bank from an affiliate (except as may be exempted by order or regulation), the acceptance by the Bank of securities issued by an affiliate as collateral and the issuance by the Bank of a guarantee, acceptance by the Bank of letters of credit on behalf of an affiliate (collectively, Covered Transactions) be on terms and conditions consistent with safe and sound banking practices. Section 23A also imposes quantitative restrictions on the amount of and collateralization requirements on such transactions. Section 23B requires that all Covered Transactions and certain other transactions, including the sale of securities or other assets by the Bank to an affiliate and the payment of money or the furnishing of services by the Bank to an affiliate, be on terms comparable to those prevailing for similar transactions with non-affiliates.

The Bank is also subject to Sections 22(g) and 22(h) of the Federal Reserve Act, and their implementing Regulation O issued by the Federal Reserve Board. These provisions impose limitations on loans and extensions of credit by the Bank to its executive officers, directors and principal shareholders and their related interests as well as to the Corporation and any subsidiary of the Corporation. The limitations restrict the terms and aggregate amount of such transactions. Regulation O also imposes certain recordkeeping and reporting requirements.

### *Deposit Insurance and Premiums*

The deposits of the Bank are insured up to applicable limits per insured depositor by the FDIC. The Dodd-Frank Act has permanently increased the standard maximum deposit insurance amount to \$250,000 per depositor per insured depository institution, retroactive to January 1, 2008, and qualifying non-interest bearing transaction accounts had unlimited deposit insurance through December 31, 2012.



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The Dodd-Frank Act also broadens the base for FDIC insurance assessments. Assessments will now be based on the average consolidated total assets less tangible equity capital of a financial institution.

### *Other Federal Laws and Regulations*

State usury and other credit laws limit the amount of interest and various other charges collected or contracted by a bank on loans. The Bank is also subject to lending limits on loans to one borrower and regulatory guidance on concentrations of credit. The Bank's loans and other products and services are also subject to numerous federal and state consumer financial protection laws, including, but not limited to, the following:

Truth-In-Lending Act, which governs disclosures of credit terms to consumer borrowers;

Truth-in-Savings Act, which governs disclosures of the terms of deposit accounts to consumers;

Home Mortgage Disclosure Act, requiring financial institutions to provide information to regulators to enable determinations as to whether financial institutions are fulfilling their obligations to meet the home lending needs of the communities they serve and not discriminating in their lending practices;

Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, gender or other prohibited factors in extending credit;

Real Estate Settlement Procedures Act, which imposes requirements relating to real estate settlements, including requiring lenders to disclose certain information regarding the nature and cost of real estate settlement services;

Fair Credit Reporting Act, covering numerous areas relating to certain types of consumer information and identity theft;

Privacy provisions of the Gramm-Leach-Bliley Act and related regulations, which require that financial institutions provide privacy policies to consumers, to allow customers to opt out of certain sharing of their nonpublic personal information, and to safeguard sensitive and confidential customer information.

Electronic Fund Transfer Act, which is a consumer protection law regarding electronic fund transfers;

The Bank Secrecy Act and USA Patriot Act, which require financial institutions to take certain actions to help prevent, detect and prosecute money laundering and the financing of terrorism; and

Numerous other federal and state laws and regulations, including those related to consumer protection and bank operations.

### *Sarbanes-Oxley Act of 2002*

The Sarbanes-Oxley Act of 2002 was enacted on July 30, 2002 and represented a comprehensive revision of laws affecting corporate governance, accounting obligations and corporate reporting. The Sarbanes-Oxley Act is applicable to all companies with equity securities registered or that file reports under the Securities Exchange Act of 1934, as amended, including publicly-held financial holding companies such as the Corporation. In particular, the Sarbanes-Oxley Act establishes: (i) requirements for audit committees, including independence, expertise, and responsibilities; (ii) additional



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responsibilities regarding financial statements for the Chief Executive Officer and Chief Financial Officer of the reporting company; (iii) standards for auditors and regulation of audits; (iv) increased disclosure and reporting obligations for the reporting company and its directors and executive officers; and (v) new and increased civil and criminal penalties for violations of the securities laws. Many of the provisions were effective immediately while other provisions became effective over a period of time and are subject to rulemaking by the SEC.

### *Governmental Policies*

Our earnings are significantly affected by the monetary and fiscal policies of governmental authorities, including the Federal Reserve Board. Among the instruments of monetary policy used by the Federal Reserve Board to implement these objectives are open-market operations in U.S. Government securities and federal funds, changes in the discount rate on member bank borrowings and changes in reserve requirements against member bank deposits. These instruments of monetary policy are used in varying combinations to influence the overall level of bank loans, investments and deposits, and the interest rates charged on loans and paid for deposits. The Federal Reserve Board frequently uses these instruments of monetary policy, especially its open-market operations and the discount rate, to influence the level of interest rates and to affect the strength of the economy, the level of inflation or the price of the dollar in foreign exchange markets. The monetary policies of the Federal Reserve Board have had a significant effect on the operating results of banking institutions in the past and are expected to continue to do so in the future. It is not possible to predict the nature of future changes in monetary and fiscal policies, or the effect which they may have on our business and earnings.

### *Other Legislative Initiatives*

Proposals may be introduced in the United States Congress, in the Pennsylvania Legislature, and/or by various bank regulatory authorities that could alter the powers of, and restrictions on, different types of banking organizations and which could restructure part or all of the existing regulatory framework for banks, bank and financial holding companies and other providers of financial services. Moreover, other bills may be introduced in Congress which would further regulate, deregulate or restructure the financial services industry, including proposals to substantially reform the regulatory framework. It is not possible to predict whether these or any other proposals will be enacted into law or, even if enacted, the effect which they may have on our business and earnings.

## **Employees**

As of December 31, 2012, the Corporation had a total of 337 employees of which 297 were full time and 40 were part time.

**Table of Contents****Executive Officers**

The Corporation's executive officers, their ages, and their principal occupations are as follows:

| Name                     | Age | Principal Occupation   |
|--------------------------|-----|--|
| Joseph B. Bower, Jr.     | 49  | President and Chief Executive Officer, CNB Bank and CNB Financial Corporation, since January 1, 2010; and previously, Secretary, CNB Financial Corporation and Executive Vice President and Chief Operating Officer, CNB Bank.   |
| Mark D. Breakey          | 54  | Executive Vice President and Chief Credit Officer, CNB Bank.   |
| Richard L. Greslick, Jr. | 36  | Executive Vice President/Chief Operating Officer, CNB Bank since December 2012 and Secretary, CNB Financial Corporation, since July 2010; previously, Senior Vice President/Administration since July 2010; Vice President/Operations since 2007; and previously Controller, CNB Bank and CNB Financial Corporation.                         |
| Richard L. Sloppy        | 62  | Executive Vice President and Senior Loan Officer, CNB Bank.  |
| Vincent C. Turiano       | 62  | Senior Vice President/Operations, CNB Bank, since November 25, 2009; previously Financial Consultant for RBC Wealth Management (formerly Ferris, Baker Watts, Inc.) since 2006; and previously Executive Vice President of Omega Bank and Omega Financial Corporation.   |
| Brian W. Wingard         | 38  | Treasurer, Principal Financial Officer and Principal Accounting Officer, CNB Financial Corporation, since March 2012; Senior Vice President/Chief Financial Officer, CNB Bank, since March 2012; previously Controller, CNB Bank and CNB Financial Corporation, since 2007; and previously a Certified Public Accountant in public practice. |

Officers are elected annually at the reorganization meeting of the Board of Directors. There are no arrangements or understandings between any officer and any other persons pursuant to which he was selected as an officer.

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**Available Information**

The Corporation makes available free of charge on its website ([www.bankcnb.com](http://www.bankcnb.com)) its Annual Report on Form 10-K, its quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as practicable after it electronically files such material with, or furnishes it to, the Securities and Exchange Commission, the SEC. Information on the Corporation's website is not incorporated by reference into this report.

Shareholders may obtain a copy of the Corporation's Annual Report on Form 10-K free of charge by writing to: CNB Financial Corporation, 1 South Second Street, PO Box 42, Clearfield, PA 16830, Attn: Shareholder Relations.

Interested persons may also read and copy materials the Corporation files with, or furnishes to, the SEC at the SEC's Public Reference Room at 100 F Street, NE Washington, DC 20549. Information concerning the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The SEC also maintains an internet site that contains reports, proxy statements and other information about electronic filers such as the Corporation. The site is available at <http://www.sec.gov>.

**Statistical Disclosure**

The following tables set forth statistical information relating to the Corporation and its wholly owned subsidiaries. The tables should be read in conjunction with the consolidated financial statements of the Corporation.

**Table of Contents****Average Balances and Net Interest Margin****(Dollars in thousands)**

|  | December 31, 2012   |              |                        | December 31, 2011   |              |                        | December 31, 2010   |              |                        |
|--|---------------------|--------------|------------------------|---------------------|--------------|------------------------|---------------------|--------------|------------------------|
|  | Average Balance     | Annual Rate  | Interest Inc./<br>Exp. | Average Balance     | Annual Rate  | Interest Inc./<br>Exp. | Average Balance     | Annual Rate  | Interest Inc./<br>Exp. |
| <b>Assets</b>                              |                     |              |                        |                     |              |                        |                     |              |                        |
| Interest-bearing deposits with banks       | \$ 3,891            | 0.08%        | \$ 3                   | \$ 11,475           | 0.96%        | \$ 110                 | \$ 8,680            | 1.44%        | \$ 125                 |
| <b>Securities:</b>                         |                     |              |                        |                     |              |                        |                     |              |                        |
| Taxable (1)                                | 602,083             | 2.51%        | 14,685                 | 487,746             | 2.97%        | 14,285                 | 383,373             | 3.02%        | 11,603                 |
| Tax-Exempt (1, 2)                          | 115,634             | 4.89%        | 5,344                  | 86,851              | 5.14%        | 4,366                  | 69,033              | 5.28%        | 3,572                  |
| Equity Securities (1, 2)                   | 2,843               | 4.08%        | 116                    | 1,906               | 2.49%        | 47                     | 1,607               | 2.30%        | 37                     |
| <b>Total Securities</b>                    | <b>720,560</b>      | <b>2.89%</b> | <b>20,145</b>          | <b>576,503</b>      | <b>3.29%</b> | <b>18,698</b>          | <b>454,013</b>      | <b>3.35%</b> | <b>15,212</b>          |
| <b>Loans</b>                               |                     |              |                        |                     |              |                        |                     |              |                        |
| Commercial (2)                             | 296,465             | 4.96%        | 14,718                 | 275,442             | 5.20%        | 14,329                 | 258,550             | 5.62%        | 14,542                 |
| Mortgage (2)                               | 546,374             | 5.29%        | 28,919                 | 492,922             | 5.68%        | 28,015                 | 431,599             | 6.14%        | 26,514                 |
| Consumer                                   | 50,069              | 13.27%       | 6,642                  | 51,402              | 12.72%       | 6,536                  | 51,565              | 12.81%       | 6,605                  |
| <b>Total Loans (3)</b>                     | <b>892,908</b>      | <b>5.63%</b> | <b>50,279</b>          | <b>819,766</b>      | <b>5.96%</b> | <b>48,880</b>          | <b>741,714</b>      | <b>6.43%</b> | <b>47,661</b>          |
| <b>Total earning assets</b>                | <b>1,617,359</b>    | <b>4.42%</b> | <b>\$ 70,427</b>       | <b>1,407,744</b>    | <b>4.84%</b> | <b>\$ 67,688</b>       | <b>1,204,407</b>    | <b>5.23%</b> | <b>\$ 62,998</b>       |
| <b>Non Interest Earning Assets</b>         |                     |              |                        |                     |              |                        |                     |              |                        |
| Cash & Due From Banks                      | 30,275              |              |                        | 33,846              |              |                        | 33,885              |              |                        |
| Premises & Equipment                       | 24,114              |              |                        | 24,323              |              |                        | 23,969              |              |                        |
| Other Assets                               | 55,851              |              |                        | 56,616              |              |                        | 53,867              |              |                        |
| Allowance for Loan Losses                  | (13,424)            |              |                        | (11,750)            |              |                        | (10,443)            |              |                        |
| <b>Total Non Interest Earning Assets</b>   | <b>96,816</b>       |              |                        | <b>103,035</b>      |              |                        | <b>101,278</b>      |              |                        |
| <b>Total Assets</b>                        | <b>\$ 1,714,175</b> |              |                        | <b>\$ 1,510,779</b> |              |                        | <b>\$ 1,305,685</b> |              |                        |
| <b>Liabilities and Shareholders Equity</b> |                     |              |                        |                     |              |                        |                     |              |                        |
| <b>Interest-Bearing Deposits</b>           |                     |              |                        |                     |              |                        |                     |              |                        |
| Demand interest-bearing                    | \$ 313,673          | 0.50%        | \$ 1,559               | \$ 296,440          | 0.77%        | \$ 2,287               | \$ 258,826          | 0.75%        | \$ 1,954               |
| Savings                                    | 738,023             | 0.76%        | 5,595                  | 501,475             | 1.09%        | 5,489                  | 346,346             | 1.29%        | 4,464                  |
| Time                                       | 229,694             | 1.62%        | 3,721                  | 320,704             | 1.82%        | 5,849                  | 349,401             | 2.04%        | 7,140                  |
| <b>Total interest bearing deposits</b>     | <b>1,281,390</b>    | <b>0.85%</b> | <b>10,875</b>          | <b>1,118,619</b>    | <b>1.22%</b> | <b>13,625</b>          | <b>954,573</b>      | <b>1.42%</b> | <b>13,558</b>          |
| Short-term borrowings                      | 9,402               | 0.15%        | 14                     | 9,728               | 0.28%        | 27                     | 5,282               | 0.15%        | 8                      |
| Long-term borrowings                       | 74,370              | 4.34%        | 3,231                  | 74,141              | 4.25%        | 3,149                  | 87,336              | 5.39%        | 4,708                  |
| Subordinated Debentures                    | 20,620              | 3.88%        | 800                    | 20,620              | 3.77%        | 778                    | 20,620              | 3.79%        | 782                    |
| <b>Total interest-bearing liabilities</b>  | <b>1,385,782</b>    | <b>1.08%</b> | <b>\$ 14,920</b>       | <b>1,223,108</b>    | <b>1.44%</b> | <b>\$ 17,579</b>       | <b>1,067,811</b>    | <b>1.78%</b> | <b>\$ 19,056</b>       |
| Demand non-interest-bearing                | 164,368             |              |                        | 148,287             |              |                        | 127,287             |              |                        |
| Other liabilities                          | 23,174              |              |                        | 17,173              |              |                        | 13,203              |              |                        |
| <b>Total Liabilities</b>                   | <b>1,573,324</b>    |              |                        | <b>1,388,568</b>    |              |                        | <b>1,208,301</b>    |              |                        |
| Shareholders Equity                        | 140,851             |              |                        | 122,211             |              |                        | 97,384              |              |                        |

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|  |       |                 |  |              |                 |                 |
|--|-------|-----------------|--|--------------|-----------------|-----------------|
| <b>Total Liabilities and Shareholders Equity</b> |       | \$ 1,714,175    |  | \$ 1,510,779 |                 | \$ 1,305,685    |
| Interest Income/Earning Assets                   | 4.42% | \$ 70,427       |  | 4.84%        | \$ 67,688       | 5.23% \$ 62,998 |
| Interest Expense/Interest Bearing Liabilities    | 1.08% | 14,920          |  | 1.44%        | 17,579          | 1.78% 19,056    |
| <b>Net Interest Spread</b>                       |       | 3.34% \$ 55,507 |  |              | 3.40% \$ 50,109 | 3.45% \$ 43,942 |
| Interest Income/Earning Assets                   | 4.42% | \$ 70,427       |  | 4.84%        | \$ 67,688       | 5.23% \$ 62,998 |
| Interest Expense/Earning Assets                  | 0.92% | 14,920          |  | 1.25%        | 17,579          | 1.58% 19,056    |
| <b>Net Interest Margin</b>                       |       | 3.49% \$ 55,507 |  |              | 3.59% \$ 50,109 | 3.65% \$ 43,942 |

1. Includes unamortized discounts and premiums. Average balance is computed using the carrying value of securities. The average yield has been computed using the historical amortized cost average balance for available for sale securities.
2. Average yields and interest income are stated on a fully taxable equivalent basis using the Corporation's marginal federal income tax rate of 35%. Interest income has been increased by \$2,298, \$1,976, and \$1,851 for the years ended December 31, 2012, 2011, and 2010, respectively, as a result of the effect of tax-exempt interest and dividends earned by the Corporation.
3. Average outstanding includes the average balance outstanding of all non-accrual loans. Loans consist of the average of total loans less average unearned income. Included in loan interest income is loan fees of \$1,636, \$1,567, and \$1,835 for the years ended December 31, 2012, 2011, and 2010, respectively.

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| Net Interest Income                        | For Twelve Months Ended<br>December 31, 2012 over<br>(under) 2011 |                   |                   | For Twelve Months Ended<br>December 31, 2011 over<br>(under) 2010 |                   |                   |
|--|---|-------------------|-------------------|---|-------------------|-------------------|
|  | Due to Change In (1)  |                   |                   | Due to Change In (1)  |                   |                   |
| Rate-Volume Variance                       | Volume  | Rate              | Net               | Volume  | Rate              | Net               |
| (Dollars in thousands)                     |   |                   |                   |   |                   |                   |
| <b>Assets</b>                              |   |                   |                   |   |                   |                   |
| Interest-Bearing Deposits with Banks       | \$ (73)   | \$ (34)           | \$ (107)          | \$ 40   | \$ (55)           | \$ (15)           |
| Securities:                                |   |                   |                   |   |                   |                   |
| Taxable                                    | 3,170   | (2,770)           | 400               | 2,926   | (244)             | 2,682             |
| Tax-Exempt (2)                             | 1,267   | (289)             | 978               | 916   | (122)             | 794               |
| Equity Securities (2)                      | 24  | 45                | 69                | 6   | 4                 | 10                |
| <b>Total Securities</b>                    | <b>4,460</b>  | <b>(3,013)</b>    | <b>1,447</b>      | <b>3,848</b>  | <b>(362)</b>      | <b>3,486</b>      |
| <b>Loans</b>                               |   |                   |                   |   |                   |                   |
| Commercial (2)                             | 1,094   | (705)             | 389               | 950   | (1,163)           | (213)             |
| Mortgage (2)                               | 3,038   | (2,134)           | 904               | 3,767   | (2,266)           | 1,501             |
| Consumer                                   | (169)   | 275               | 106               | (21)  | (48)              | (69)              |
| <b>Total Loans (3)</b>                     | <b>3,962</b>  | <b>(2,563)</b>    | <b>1,399</b>      | <b>4,696</b>  | <b>(3,477)</b>    | <b>1,219</b>      |
| <b>Total Earning Assets</b>                | <b>\$ 8,350</b>   | <b>\$ (5,611)</b> | <b>\$ 2,739</b>   | <b>\$ 8,584</b>   | <b>\$ (3,894)</b> | <b>\$ 4,690</b>   |
| <b>Liabilities and Shareholders Equity</b> |   |                   |                   |   |                   |                   |
| <b>Interest-Bearing Deposits</b>           |   |                   |                   |   |                   |                   |
| Demand Interest-Bearing                    | \$ 133  | \$ (861)          | \$ (728)          | \$ 284  | \$ 49             | \$ 333            |
| Savings                                    | 2,589   | (2,483)           | 106               | 1,999   | (974)             | 1,025             |
| Time                                       | (1,660)   | (468)             | (2,128)           | (586)   | (705)             | (1,291)           |
| <b>Total Interest-Bearing Deposits</b>     | <b>1,062</b>  | <b>(3,812)</b>    | <b>(2,750)</b>    | <b>1,697</b>  | <b>(1,630)</b>    | <b>67</b>         |
| Short-Term Borrowings                      | (1)   | (12)              | (13)              | 7   | 12                | 19                |
| Long-Term Borrowings                       | 10  | 72                | 82                | (711)   | (848)             | (1,559)           |
| Subordinated debentures                    | -   | 22                | 22                | -   | (4)               | (4)               |
| <b>Total Interest-Bearing Liabilities</b>  | <b>\$ 1,072</b>   | <b>\$ (3,731)</b> | <b>\$ (2,659)</b> | <b>\$ 993</b>   | <b>\$ (2,470)</b> | <b>\$ (1,477)</b> |
| <b>Change in Net Interest Income</b>       | <b>\$ 7,278</b>   | <b>\$ (1,880)</b> | <b>\$ 5,398</b>   | <b>\$ 7,591</b>   | <b>\$ (1,424)</b> | <b>\$ 6,167</b>   |

1. The change in interest due to both volume and rate have been allocated entirely to volume changes.
2. Changes in interest income on tax-exempt securities and loans are presented on a fully taxable-equivalent basis, using the Corporation's marginal federal income tax rate of 35%.



**Table of Contents****Securities**

|                                       | December 31, 2012 |          |            |           | December 31, 2011 |          |            |           | December 31, 2010 |         |            |           |
|---------------------------------------|-------------------|----------|------------|-----------|-------------------|----------|------------|-----------|-------------------|---------|------------|-----------|
|                                       | Amortized         |          | Unrealized |           | Amortized         |          | Unrealized |           | Amortized         |         | Unrealized |           |
|                                       | Cost              | Gains    | Losses     | Value     | Cost              | Gains    | Losses     | Value     | Cost              | Gains   | Losses     | Value     |
| <b>Securities Available for Sale</b>  |                   |          |            |           |                   |          |            |           |                   |         |            |           |
| U.S. Treasury                         | \$4,018           | \$18     | \$ -       | \$4,036   | \$8,064           | \$66     | \$ -       | \$8,130   | \$8,139           | \$66    | \$ -       | \$8,205   |
| U.S. Government Sponsored Entities    | 157,965           | 5,977    | (161)      | 163,781   | 102,258           | 5,249    | (15)       | 107,492   | 104,328           | 2,016   | (403)      | 105,941   |
| State and Political Subdivisions      | 170,223           | 11,113   | (57)       | 181,279   | 149,685           | 8,844    | (92)       | 158,437   | 117,928           | 1,011   | (2,528)    | 116,411   |
| Residential and multi-family mortgage | 308,800           | 8,724    | (702)      | 316,822   | 292,297           | 8,043    | (214)      | 300,126   | 221,304           | 2,364   | (1,249)    | 222,419   |
| Commercial mortgage                   | 1,275             | 29       | -          | 1,304     | 2,077             | 45       | -          | 2,122     | -                 | -       | -          | -         |
| Corporate notes and bonds             | 17,368            | 26       | (2,370)    | 15,024    | 17,358            | 50       | (3,548)    | 13,860    | 14,347            | -       | (3,596)    | 10,751    |
| Pooled trust preferred                | 800               | -        | (200)      | 600       | 800               | -        | (460)      | 340       | 2,190             | 12      | (910)      | 1,292     |
| Pooled SBA                            | 50,667            | 2,277    | (17)       | 52,927    | 44,851            | 1,282    | (77)       | 46,056    | 33,788            | 266     | (92)       | 33,962    |
| Other securities                      | 1,521             | 17       | -          | 1,538     | 1,521             | 23       | -          | 1,544     | 1,670             | 26      | -          | 1,696     |
|                                       | \$712,637         | \$28,181 | \$(3,507)  | \$737,311 | \$618,911         | \$23,602 | \$(4,406)  | \$638,107 | \$503,694         | \$5,761 | \$(8,778)  | \$500,677 |

**Maturity Distribution of Investment Securities**

(Dollars In Thousands)

December 31, 2012

|                                       | Within One Year |       | After One But Within Five Years |       | After Five But Within Ten Years |       | After Ten Years |       | Pooled SBA, Residential and Multi-Family Mortgage and Commercial Mortgage |       |
|---------------------------------------|-----------------|-------|---------------------------------|-------|---------------------------------|-------|-----------------|-------|---|-------|
|                                       | \$ Amt.         | Yield | \$ Amt.                         | Yield | \$ Amt.                         | Yield | \$ Amt.         | Yield | \$ Amt.   | Yield |
|                                       |                 |       |                                 |       |                                 |       |                 |       |   |       |
| <b>Securities Available for Sale</b>  |                 |       |                                 |       |                                 |       |                 |       |   |       |
| U.S. Treasury                         | \$4,036         | 0.83% |                                 |       |                                 |       |                 |       |   |       |
| U.S. Government Sponsored Entities    | 18,163          | 2.02% | 62,056                          | 1.77% | \$83,562                        | 2.28% |                 |       |   |       |
| State and Political Subdivisions      | 4,542           | 5.44% | 43,133                          | 3.98% | 92,036                          | 4.59% | \$41,568        | 5.35% |   |       |
| Corporate notes and bonds             |                 |       | 1,001                           | 6.25% | 1,935                           | 4.00% | 12,088          | 2.47% |   |       |
| Pooled trust preferred                |                 |       |                                 |       |                                 |       | 600             | 0.00% |   |       |
| Pooled SBA                            |                 |       |                                 |       |                                 |       |                 |       | \$52,927  | 3.08% |
| Residential and multi-family mortgage |                 |       |                                 |       |                                 |       |                 |       | 316,822   | 2.23% |
| Commercial mortgage                   |                 |       |                                 |       |                                 |       |                 |       | 1,304   | 4.70% |
| TOTAL                                 | \$26,741        | 2.42% | \$106,190                       | 2.71% | \$177,533                       | 3.50% | \$54,256        | 4.65% | \$371,053   | 2.36% |

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The weighted average yields are based on market value and effective yields weighted for the scheduled maturity with tax-exempt securities adjusted to a taxable-equivalent basis using a tax rate of 35%.

The portfolio contains no holdings of a single issuer that exceeds 10% of shareholders' equity other than the US Treasury and governmental sponsored entities.

**Table of Contents****LOAN PORTFOLIO**

(Dollars in thousands)

**A. TYPE OF LOAN**

|   | 2012       | 2011       | 2010       | 2009       | 2008       |
|---|------------|------------|------------|------------|------------|
| Commercial, industrial and agricultural | \$ 257,091 | \$ 253,324 | \$ 257,491 | \$ 239,966 | \$ 227,141 |
| Commercial mortgages                    | 261,791    | 242,511    | 212,878    | 193,632    | 210,080    |
| Residential real estate                 | 347,904    | 298,628    | 266,604    | 226,931    | 179,420    |
| Consumer                                | 58,668     | 53,471     | 51,966     | 53,542     | 55,554     |
| Credit cards                            | 4,800      | 4,412      | 4,106      | 3,560      | 3,098      |
| Overdrafts                              | 971        | 423        | 3,964      | 391        | 859        |
| Gross loans                             | 931,225    | 852,769    | 797,009    | 718,022    | 676,152    |
| Less: unearned income                   | 3,401      | 2,886      | 2,447      | 2,880      | 4,596      |
| Total loans net of unearned             | \$ 927,824 | \$ 849,883 | \$ 794,562 | \$ 715,142 | \$ 671,556 |

**B. LOAN MATURITIES AND INTEREST SENSITIVITY**

|  | December 31, 2012 |                        |                 | Total Gross Loans |
|--|-------------------|------------------------|-----------------|-------------------|
|  | One Year or Less  | One Through Five Years | Over Five Years |                   |
| <u>Commercial, industrial and agricultural</u> |                   |                        |                 |                   |
| Loans With Fixed Interest Rate                 | \$ 106,804        | \$ 62,837              | \$ 13,779       | \$ 183,420        |
| Loans With Floating Interest Rate              | 16,361            | 28,173                 | 29,137          | 73,671            |
|  | \$ 123,165        | \$ 91,010              | \$ 42,916       | \$ 257,091        |

**C. RISK ELEMENTS**

|   | 2012      | 2011      | 2010      | 2009      | 2008     |
|---|-----------|-----------|-----------|-----------|----------|
| Loans on non-accrual basis  | \$ 14,445 | \$ 16,567 | \$ 11,926 | \$ 12,757 | \$ 3,046 |
| Accruing loans which are contractually past due 90 days or more as to interest or principal payment | 357       | 441       | 889       | 584       | 533      |
| Performing troubled debt restructurings   | 9,961     | 7,688     | 1,714     | -         | -        |
|   | \$ 24,763 | \$ 24,696 | \$ 14,529 | \$ 13,341 | \$ 3,579 |

Interest income recorded on the non-accrual loans for the year ended December 31, 2012 was \$20. Additional interest income which would have been recorded on non-accrual loans had they been on accrual status was \$542 for the year ended December 31, 2012.

Loans are placed in non-accrual status when the interest or principal is 90 days past due, unless the loan is in collection, well secured and it is believed that there will be no loss of interest or principal.

At December 31, 2012, there were \$18,935 in special mention loans, \$38,960 in substandard loans, and \$858 in doubtful loans which are considered problem loans. These loans are not included in the table above. In the opinion of management, these loans are adequately secured and

losses are believed to be minimal.

**Table of Contents****SUMMARY OF LOAN LOSS EXPERIENCE**

(Dollars in Thousands)

| Analysis of the Allowance for Loan Losses                                    |           |           |           |          |          |
|--|-----------|-----------|-----------|----------|----------|
| Years Ended December 31,   | 2012      | 2011      | 2010      | 2009     | 2008     |
| Balance at beginning of Period   | \$ 12,615 | \$ 10,820 | \$ 9,795  | \$ 8,719 | \$ 6,773 |
| Charge-Offs:   |           |           |           |          |          |
| Commercial, industrial and agricultural                                      | 2,871     | 1,796     | 543       | 860      | 33       |
| Commercial mortgages   | 401       | 175       | 2,061     | 381      | 178      |
| Residential real estate  | 304       | 217       | 211       | 378      | 330      |
| Consumer   | 1,279     | 907       | 1,223     | 1,622    | 1,123    |
| Credit cards   | 78        | 39        | 94        | 101      | 46       |
| Overdrafts   | 257       | 222       | 239       | 269      | 334      |
|  | 5,190     | 3,356     | 4,371     | 3,611    | 2,044    |
| Recoveries:  |           |           |           |          |          |
| Commercial, industrial and agricultural                                      | 45        | 9         | 11        | 2        | 2        |
| Commercial mortgages   | -         | -         | 3         | -        | -        |
| Residential real estate  | 1         | 13        | 2         | 1        | 6        |
| Consumer   | 91        | 88        | 100       | 62       | 72       |
| Credit cards   | 18        | 10        | 10        | 13       | 12       |
| Overdrafts   | 99        | 94        | 112       | 144      | 111      |
|  | 254       | 214       | 238       | 222      | 203      |
| Net charge-offs  | (4,936)   | (3,142)   | (4,133)   | (3,389)  | (1,841)  |
| Provision for loan losses  | 6,381     | 4,937     | 5,158     | 4,465    | 3,787    |
| Balance at end of period   | \$ 14,060 | \$ 12,615 | \$ 10,820 | \$ 9,795 | \$ 8,719 |
| Percentage of net charge-offs during the period to average loans outstanding |           |           |           |          |          |
|  | 0.55%     | 0.38%     | 0.56%     | 0.49%    | 0.28%    |

The provision for loan losses reflects the amount deemed appropriate by management to establish an adequate reserve to meet the present and foreseeable risk characteristics of the present loan portfolio. Management's judgment is based on the evaluation of individual loans, the overall risk characteristics of various portfolio segments, past experience with losses, the impact of economic conditions on borrowers, and other relevant factors.

**ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES**

(Dollars In Thousands)

|                             | 2012     |                    | 2011     |                    | 2010     |                    | 2009     |                    | 2008     |                    |
|-----------------------------|----------|--------------------|----------|--------------------|----------|--------------------|----------|--------------------|----------|--------------------|
|                             | Amount   | % of Loans in each | Amount   | % of Loans in each | Amount   | % of Loans in each | Amount   | % of Loans in each | Amount   | % of Loans in each |
| Commercial, industrial, and | \$ 4,940 | 27.61%             | \$ 4,511 | 29.71%             | \$ 3,517 | 32.31%             | \$ 2,790 | 33.42%             | \$ 2,660 | 33.59%             |

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|                  |           |         |           |         |           |         |          |         |          |         |
|------------------|-----------|---------|-----------|---------|-----------|---------|----------|---------|----------|---------|
| agricultural     |           |         |           |         |           |         |          |         |          |         |
| Commercial       |           |         |           |         |           |         |          |         |          |         |
| mortgages        | 4,697     | 28.11%  | 4,470     | 28.44%  | 3,511     | 26.71%  | 3,291    | 26.97%  | 2,836    | 31.07%  |
| Residential real |           |         |           |         |           |         |          |         |          |         |
| estate           | 2,466     | 37.36%  | 1,991     | 35.02%  | 1,916     | 33.45%  | 1,583    | 31.61%  | 1,273    | 26.54%  |
| Consumer         | 1,699     | 6.30%   | 1,404     | 6.27%   | 1,561     | 6.52%   | 1,751    | 7.46%   | 1,589    | 8.22%   |
| Credit Cards     | 83        | 0.51%   | 71        | 0.51%   | 96        | 0.52%   | 85       | 0.49%   | 82       | 0.46%   |
| Overdrafts       | 175       | 0.10%   | 168       | 0.05%   | 219       | 0.50%   | 295      | 0.05%   | 279      | 0.13%   |
| Total            | \$ 14,060 | 100.00% | \$ 12,615 | 100.00% | \$ 10,820 | 100.00% | \$ 9,795 | 100.00% | \$ 8,719 | 100.00% |

In determining the allocation of the allowance for loan losses, the Corporation considers economic trends, historical patterns and specific credit reviews.

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With regard to the credit reviews, a watchlist is evaluated on a monthly basis to determine potential commercial losses. Consumer loans and mortgage loans are allocated using historical loss experience.

**DEPOSITS**

(Dollars In Thousands)

|                             | 2012                |                | Year Ended December 31,<br>2011 |                | 2010                |                |
|-----------------------------|---------------------|----------------|---------------------------------|----------------|---------------------|----------------|
|                             | Average<br>Amount   | Annual<br>Rate | Average<br>Amount               | Annual<br>Rate | Average<br>Amount   | Annual<br>Rate |
| Demand Non Interest Bearing | \$ 164,368          |                | \$ 148,287                      |                | \$ 127,287          |                |
| Demand Interest Bearing     | 313,673             | 0.50%          | 296,440                         | 0.77%          | 258,826             | 0.75%          |
| Savings Deposits            | 738,023             | 0.76%          | 501,475                         | 1.09%          | 346,346             | 1.29%          |
| Time Deposits               | 229,694             | 1.62%          | 320,704                         | 1.82%          | 349,401             | 2.04%          |
| <b>TOTAL</b>                | <b>\$ 1,445,758</b> |                | <b>\$ 1,266,906</b>             |                | <b>\$ 1,081,860</b> |                |

The maturity of certificates of deposits and other time deposits

in denominations of \$100,000 or more as of December 31, 2012 is as follows:

|   |           |
|---|-----------|
| Three months or less                                | \$ 17,531 |
| Greater than three months and through twelve months | 16,969    |
| Greater than one year and through three years       | 39,874    |
| Greater than three years                            | 12,644    |
|   | \$ 87,018 |

**RETURN ON EQUITY AND ASSETS**

|  | Year Ended December 31, |        |        |
|--|-------------------------|--------|--------|
|  | 2012                    | 2011   | 2010   |
| Return on average assets               | 1.00%                   | 1.00%  | 0.87%  |
| Return on average equity               | 12.17%                  | 12.36% | 11.62% |
| Dividend payout ratio                  | 47.93%                  | 53.79% | 61.27% |
| Average equity to average assets ratio | 8.22%                   | 8.09%  | 7.46%  |

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**ITEM 1A. RISK FACTORS**

The Corporation's financial condition and results of operations are subject to various risks inherent in its business. The material risks and uncertainties that management believes affect the Corporation are described below. If any of these risks actually occur, the Corporation's business, financial condition, liquidity, results of operations and prospects could be materially and adversely affected. You should consider all of the following risks together with all of the other information in this Annual Report on Form 10-K.

*The possibility of the economy's return to recessionary conditions and the possibility of further turmoil or volatility in the financial markets would likely have an adverse effect on the Corporation's business, financial position and results of operations.*

The economy in the United States and globally began to recover from severe recessionary conditions in mid-2009 and is currently in the midst of a moderate economic recovery. The sustainability of the moderate recovery is dependent on a number of factors that are not within the Corporation's control, such as a return to private sector job growth and investment, strengthening of housing sales and construction, continuation of the economic recovery globally, and the timing and impact of changing governmental policies. The Corporation continues to face risks resulting from the aftermath of the severe recession generally and the moderate pace of the current recovery. A slowing or failure of the economic recovery would likely aggravate the adverse effects of these difficult economic and market conditions on the Corporation and on others in the financial services industry. In particular, the Corporation may face the following risks in connection with the current economic or market environment:

The Corporation's and the Bank's ability to borrow from other financial institutions or to access the debt or equity capital markets on favorable terms or at all could be adversely affected by further disruptions in the capital markets or other events, including actions by rating agencies and deteriorating investor expectations.

The Corporation expects to face increased regulation of the banking and financial services industry. Compliance with such regulation may increase its costs and limit its ability to pursue business opportunities.

Market developments may affect customer confidence levels and may cause increases in loan delinquencies and default rates, which management expects would adversely impact the Bank's charge-offs and provision for loan losses.

Market developments may adversely affect the Bank's securities portfolio by causing other-than-temporary-impairments, prompting write-downs and securities losses.

Competition in banking and financial services industry could intensify as a result of the increasing consolidation of financial services companies in connection with current market conditions.

The Bank may be required to pay significantly higher premiums to the FDIC because market developments have significantly depleted the insurance fund of the FDIC and reduced the ratio of reserves to insured deposits.

*The Bank's allowance for loan losses may not be adequate to cover loan losses which could have a material adverse effect on the Corporation's business, financial condition and results of operations.*

A significant source of risk for the Corporation arises from the possibility that losses will be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loan agreements. Most loans originated by the Bank are secured, but some loans are unsecured



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based upon management's evaluation of the creditworthiness of the borrowers. With respect to secured loans, the collateral securing the repayment of these loans principally includes a wide variety of real estate, and to a lesser extent personal property, either of which may be insufficient to cover the obligations owed under such loans.

Collateral values and the financial performance of borrowers may be adversely affected by changes in prevailing economic, environmental and other conditions, including declines in the value of real estate, changes in interest rates and debt service levels, changes in oil and gas prices, changes in monetary and fiscal policies of the federal government, widespread disease, terrorist activity, environmental contamination and other external events, which are beyond the control of the Bank. In addition, collateral appraisals that are out of date or that do not meet industry recognized standards might create the impression that a loan is adequately collateralized when in fact it is not. Although the Bank may acquire any real estate or other assets that secure defaulted loans through foreclosures or other similar remedies, the amounts owed under the defaulted loans may exceed the value of the assets acquired.

The allowance for loan losses is subject to a formal analysis by the credit administrator of CNB using a methodology whereby loan pools are segregated into special mention, substandard, doubtful and unclassified categories and the pools are evaluated based on historical loss factors. The Bank monitors delinquencies and losses on a monthly basis. The Bank has adopted underwriting and credit monitoring policies and procedures, including the review of borrower financial statements and collateral appraisals, which management believes are appropriate to mitigate the risk of loss by assessing the likelihood of borrower non-performance and the value of available collateral. The Bank also manages credit risk by diversifying its loan portfolio. An ongoing independent review, subsequent to management's review, of individual credits is performed by an independent loan review function, which reports to the Loan Committee of the Corporation's Board of Directors. However, such policies and procedures have limitations, including judgment errors in management's risk analysis, and may not prevent unexpected losses that could have a material adverse effect on the Corporation's business, financial condition and results of operations.

### ***Interest rate volatility could significantly reduce the Corporation's profitability.***

The Corporation's earnings largely depend on the relationship between the yield on its earning assets, primarily loans and investment securities, and the cost of funds, primarily deposits and borrowings. This relationship, commonly known as the net interest margin, is susceptible to significant fluctuation and is affected by economic and competitive factors that influence the yields and rates, and the volume and mix of the Bank's interest earning assets and interest bearing liabilities.

Interest rate risk can be defined as the sensitivity of net interest income and of the market value of financial instruments to the direction and frequency of changes in interest rates. Interest rate risk arises from the imbalance in the re-pricing, maturity and/or cash flow characteristics of assets and liabilities. The Corporation is subject to interest rate risk to the degree that its interest bearing liabilities re-price or mature more slowly or more rapidly or on a different basis than its interest earning assets. Changes in interest rates will affect the levels of income and expense recorded on a large portion of the Bank's assets and liabilities, and fluctuations in interest rates will impact the market value of all interest sensitive assets. Significant fluctuations in interest rates could have a material adverse impact on the Corporation's business, financial condition, results of operations, or liquidity.

The Bank's interest rate risk measurement and management techniques incorporate the re-pricing and cash flow attributes of its balance sheet and off-balance sheet instruments as they relate to current and

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potential changes in interest rates. The level of interest rate risk, measured in terms of the potential future effect on earnings, is determined through the use of static gap analysis and earnings simulation modeling under multiple interest rate scenarios. Management's objectives are to measure, monitor and develop strategies in response to the interest rate risk profile inherent in the Bank's balance sheet in order to preserve the sensitivity of net interest income to actual or potential changes in interest rates. At December 31, 2012, the interest rate sensitivity position was asset sensitive in the short-term. For further information on risk relating to interest rates, refer to Part I, Item 7a, "Quantitative and Qualitative Disclosures about Market Risk," herein.

***The Bank's loans are principally concentrated in certain areas of Pennsylvania, and adverse economic conditions in those markets could adversely affect the Corporation's business, financial condition and results of operations.***

The Corporation's success is dependent to a significant extent upon general economic conditions in the United States and, in particular, the local economies in northwest and central Pennsylvania, the primary markets served by the Bank. The Bank is particularly exposed to real estate and economic factors in the northwest and central areas of Pennsylvania, as most of its loan portfolio is concentrated among borrowers in these markets. Furthermore, because a substantial portion of the Bank's loan portfolio is secured by real estate in these areas, the value of the associated collateral is also subject to regional real estate market conditions.

The Bank is not immune to negative consequences arising from overall economic weakness and, in particular, a sharp downturn in the local real estate markets served by the Bank. While the Bank's loan portfolio has not shown significant signs of credit quality deterioration despite continued challenges in the U.S. economy, we cannot assure you that no deterioration will occur. An economic recession in the markets served by the Bank, and the nation as a whole, could negatively impact household and corporate incomes. This impact could lead to decreased loan demand and increase the number of borrowers who fail to pay the Bank interest or principal on their loans, and accordingly, could have a material adverse effect on the Corporation's business, financial condition, results of operations, or liquidity.

***The Corporation's investment securities portfolio is subject to credit risk, market risk, and liquidity risk, and declines in value in its investment securities portfolio may require it to record other than temporary impairment charges that could have a material adverse effect on its results of operations and financial condition.***

The Corporation's investment securities portfolio has risks beyond its control that can significantly influence the portfolio's fair value. These factors include, but are not limited to, rating agency downgrades of the securities, defaults of the issuers of the securities, lack of market pricing of the securities, and continued instability in the credit markets. Recent lack of market activity with respect to certain of the securities has, in certain circumstances, required the Corporation to base its fair market valuation on unobservable inputs. The Corporation has engaged valuation experts to price these certain securities using proprietary models, which incorporate assumptions that market participants would use in pricing the securities, including bid/ask spreads and liquidity and credit premiums. Any change in current accounting principles or interpretations of these principles could impact the Corporation's assessment of fair value and thus its determination of other-than-temporary impairment of the securities in its investment securities portfolio.

The Bank may be required to record other-than-temporary impairment charges on its investment securities if they suffer declines in value that are considered other-than-temporary. Numerous factors,

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including collateral deterioration underlying certain private label mortgage-backed securities, lack of liquidity for re-sales of certain investment securities, absence of reliable pricing information for certain investment securities, adverse changes in business climate, adverse actions by regulators, or unanticipated changes in the competitive environment could negatively effect the Bank's securities portfolio in future periods. An other-than-temporary impairment charge could have a material adverse effect on the Corporation's results of operations and financial condition.

***The Corporation's business and that of the Bank is highly regulated and impacted by monetary policy, limiting the manner in which the Corporation and the Bank may conduct business and obtain financing, and modifications to the existing regulatory framework under which the Corporation operates could have a material adverse effect on its business, financial condition, results of operations or liquidity.***

As a financial holding company and state-chartered financial institution, respectively, the Corporation and the Bank are subject to extensive regulation and supervision under federal and state laws and regulations. The restrictions imposed by such laws and regulations, along with the existing tax, accounting, securities, insurance, and monetary laws, regulations, rules, standards, policies and laws and interpretations, limit the manner in which the Corporation and the Bank conduct business, undertake new investments and activities, and obtain financing. These laws and regulations are designed primarily for the protection of the deposit insurance funds and consumers and not to benefit shareholders. These laws and regulations may sometimes impose significant limitations on the Corporation's operations. These laws, regulations, rules, standards, policies and interpretations are constantly evolving and may change significantly over time.

The nature, extent, and timing of the adoption of significant new laws and regulations, or changes in or repeal of existing laws and regulations, or specific actions of our regulators, could have a material adverse effect on our business, financial condition, results of operations or liquidity. Furthermore, federal monetary policy, particularly as implemented through the Federal Reserve System, significantly affects credit risk and interest rate risk conditions for the Bank and the Corporation, and any unfavorable change in these conditions could have a material adverse effect on the Corporation's business, financial condition, results of operations or liquidity.

***Compliance with the Dodd-Frank Act is increasing our regulatory compliance burdens and may increase our operating costs and/or adversely impact our earnings and/or capital ratios.***

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) was enacted on July 21, 2010. The Dodd-Frank Act represented a significant overhaul of many aspects of the regulation of the financial-services industry. Among other things, the Dodd-Frank Act created a new federal Consumer Financial Protection Bureau (CFPB), tightened capital standards, imposed clearing and margining requirements on many derivatives activities, and generally increased oversight and regulation of financial institutions and financial activities.

In addition to the self-implementing provisions of the statute, the Dodd-Frank Act calls for over 200 administrative rulemakings by various federal agencies to implement various parts of the legislation. While some rules have been finalized and/or issued in proposed form, many have yet to be proposed. It is impossible to predict when all such additional rules will be issued or finalized, and what the content of such rules will be. We will have to apply resources to ensure that we are in compliance with all applicable provisions of the Dodd-Frank Act and any implementing rules, which may increase our costs of operations and adversely impact our earnings.

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The Dodd-Frank Act and any implementing rules that are ultimately issued could have adverse implications on the financial industry, the competitive environment, and/or our ability to conduct business.

*The Corporation relies on its management and other key personnel, and the loss of any of them may adversely affect its operations.*

The Corporation is and will continue to be dependent upon the services of its executive management team. In addition, it will continue to depend on its ability to retain and recruit key client relationship managers. The unexpected loss of services of any key management personnel, or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on its business and financial condition.

*Strong competition within the Corporation's markets may have a material adverse impact on its profitability.*

The Corporation competes with an ever-increasing array of financial service providers. As noted above, as a financial holding company and state-chartered financial institution, respectively, the Corporation and the Bank are subject to extensive regulation and supervision, including, in many cases, regulations that limit the type and scope of activities. The non-bank financial service providers that compete with the Corporation and the Bank may not be subject to such extensive regulation, supervision, and tax burden. Competition from nationwide banks, as well as local institutions, is strong in the Corporation's markets.

The financial services industry is undergoing rapid technological change. In addition to improving customer services, effective use of technology increases efficiency and enables financial institutions to reduce costs. Furthermore, technological advances are likely to intensify competition by enabling more companies to provide financial resources. Accordingly, the Corporation's future success will depend in part on its ability to address customer needs by using technology. The Corporation cannot assure you that it will be able to develop new technology driven products and services, or be successful in marketing these products to its customers. Many of its competitors have far greater resources to invest in technology.

Many regional, national and international competitors have far greater assets and capitalization than the Corporation has and greater access to capital markets and can consequently offer a broader array of financial services than it can. We cannot assure you that we will continue to be able to compete effectively with other financial institutions in the future. Furthermore, developments increasing the nature or level of competition could have a material adverse effect on the Corporation's business, financial condition, results of operations, or liquidity. For further information on competition, refer to Part I, Item 1, Competition herein.

*Non-compliance with applicable laws and/or regulations, including the Bank Secrecy Act and USA Patriot Act, may adversely affect the Corporation's operations and its financial results and could result in significant fines or sanctions.*

Federal and state regulators have the ability to impose substantial sanctions, restrictions and requirements on the Corporation's banking and nonbanking subsidiaries if they determine, upon examination or otherwise, that any such subsidiary has violated laws or regulations with which it or its subsidiaries must comply, or that weaknesses or failures exist with respect to general standards of

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safety and soundness. Such enforcement actions may be formal or informal and can include, among other things, civil money penalties and orders to take certain actions or to refrain from certain actions. The imposition of regulatory sanctions, including any monetary penalties, may have a material impact on the Corporation's financial condition and results of operations, damage its reputation, and/or cause it to lose its financial holding company status. In addition, compliance with any such action could distract management's attention from the Corporation's operations, cause the Corporation to incur significant expenses, restrict it from engaging in potentially profitable activities, and limit its ability to raise capital.

The USA Patriot and Bank Secrecy Acts require financial institutions to develop programs to prevent the institutions from being used for money laundering and terrorist activities. If certain activities are detected, financial institutions are obligated to file suspicious activity reports with the U.S. Treasury Department's Financial Crimes Enforcement Network. These rules also require financial institutions to establish procedures for identifying and verifying the identity of customers seeking to open new financial accounts or conduct transactions, and require the filing of certain reports, such as those for cash transactions above a certain threshold. Financial institutions must also refrain from transacting business with certain countries or persons designated by the Office of Foreign Assets Control.

Non-compliance with laws and regulations such as these could result in significant fines or sanctions. These particular laws and regulations have significant implications for all financial institutions, establish new crimes and penalties, and require the federal banking agencies, in reviewing merger and acquisition transactions, to consider the effectiveness of the parties to such transactions in combating money laundering and terrorist activities. Even inadvertent non-compliance and technical failure to follow the regulations may result in significant fines or other penalties, which could have a material adverse impact on the Corporation's business, financial condition, results of operations or liquidity.

***A failure in or breach of the Corporation's operational or security systems or infrastructure, or those of third party vendors and other service providers, including as a result of cyber attacks, could disrupt the Corporation's businesses, result in the disclosure or misuse of confidential or proprietary information, damage its reputation, increase its costs and cause losses.***

As a financial institution, the Corporation depends on its ability to continuously process, record and monitor a large number of customer transactions and customer, public and regulatory expectations regarding operational and information security have increased over time. Accordingly, its operational systems and infrastructure must continue to be safeguarded and monitored for potential failures, disruptions and breakdowns. Although the Corporation has business continuity plans and other safeguards in place, disruptions or failures in the physical infrastructure or operating systems that support its businesses and customers, or cyber attacks or security breaches of the networks, systems or devices on which customers' personal information is stored and that customers use to access the Corporation's products and services could result in customer attrition, regulatory fines, penalties or intervention, reputational damage, reimbursement or other compensation costs, and/or additional compliance costs, any of which could materially adversely affect the Corporation's results of operations or financial condition.

Although to date the Corporation has not experienced any material losses relating to cyber attacks or other information security breaches, there can be no assurance that it will not suffer such losses in the future. The Corporation's risk and exposure to these matters remains heightened because of, among other things, the evolving nature of these threats, our plans to continue to implement our Internet

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banking and mobile banking channel strategies and develop additional remote connectivity solutions to serve our customers when and how they want to be served. As a result, cybersecurity and the continued development and enhancement of the Corporation's controls, processes and practices designed to protect its systems, computers, software, data and networks from attack, damage or unauthorized access remain a priority for the Corporation. As cyber threats continue to evolve, the Corporation may be required to expend significant additional resources to continue to modify or enhance its protective measures or to investigate and remediate any information security vulnerabilities.

***The Corporation may not be able to meet its cash flow needs on a timely basis at a reasonable cost, and the Corporation's cost of funds for banking operations may significantly increase as a result of general economic conditions, interest rates and competitive pressures.***

Liquidity is the ability to meet cash flow obligations as they come due and cash flow needs on a timely basis and at a reasonable cost. The liquidity of the Bank is used to make loans and to repay deposit and borrowing liabilities as they become due, or are demanded by customers and creditors. Many factors affect the Bank's ability to meet liquidity needs, including variations in the markets served by its network of offices, its mix of assets and liabilities, reputation and standing in the marketplace, and general economic conditions.

The Bank's primary source of funding is retail deposits, gathered throughout its network of banking offices. Periodically, the Corporation utilizes term borrowings from the Federal Home Loan Bank of Pittsburgh, or FHLB, of which the Bank is a member, and other lenders to meet funding obligations. The Bank's securities and loan portfolios provide a source of contingent liquidity that could be accessed in a reasonable time period through sales.

Significant changes in general economic conditions, market interest rates, competitive pressures or otherwise, could cause the Bank's deposits to decrease relative to overall banking operations, and it would have to rely more heavily on brokered funds and borrowings in the future, which are typically more expensive than deposits.

Management and the Board of Directors of CNB, through its Asset/Liability Committee, or the ALCO, monitor liquidity and the ALCO establishes and monitors acceptable liquidity ranges. The Bank actively manages its liquidity position through target ratios. Continual monitoring of these ratios, both historical and through forecasts under multiple rate scenarios, allows the Bank to employ strategies necessary to maintain adequate liquidity.

Changes in economic conditions, including consumer savings habits and availability of or access to capital, could potentially have a significant impact on the Bank's liquidity position, which in turn could materially impact the Corporation's financial condition, results of operations and cash flows.

***A substantial decline in the value of the Bank's FHLB common stock may adversely affect the Corporation's results of operations, liquidity and financial condition.***

As a requirement of membership in the FHLB of Pittsburgh, the Bank must own a minimum required amount of FHLB stock, calculated periodically based primarily on its level of borrowings from the FHLB. Borrowings from the FHLB represent the Bank's primary source of short-term and long-term wholesale funding.

In an extreme situation, it is possible that the capitalization of an FHLB, including the FHLB of Pittsburgh, could be substantially diminished or reduced to zero. Consequently, given that there is no

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trading market for the Bank's FHLB common stock, the Corporation's management believes that there is a risk that the Corporation's investment could be deemed impaired at some time in the future. If this occurs, it may adversely affect the Corporation's results of operations and financial condition.

In addition, if the capitalization of the FHLB of Pittsburgh is substantially diminished, the Bank's liquidity may be adversely impaired if it is not able to obtain alternative sources of funding.

There are 12 banks of the FHLB, including Pittsburgh. To conserve capital, some FHLB banks have suspended or reduced dividend payments and ceased buying back excess FHLB stock that member banks hold. The 12 FHLB banks are jointly liable for the consolidated obligations of the FHLB system. To the extent that one FHLB bank cannot meet its obligations to pay its share of the system's debt, other FHLB banks can be called upon to make the payment. The Corporation cannot assure you, however, that the FHLB system will be able to meet these obligations.

***The Bank could be held responsible for environmental liabilities relating to properties acquired through foreclosure, resulting in significant financial loss.***

In the event the Bank forecloses on a defaulted commercial or residential mortgage loan to recover its investment, it may be subject to environmental liabilities in connection with the underlying real property, which could significantly exceed the value of the real property. Although the Bank exercises due diligence to discover potential environmental liabilities prior to acquiring any property through foreclosure, hazardous substances or wastes, contaminants, pollutants, or their sources may be discovered on properties during its ownership or after a sale to a third party. The Corporation cannot assure you that the Bank would not incur full recourse liability for the entire cost of any removal and cleanup on an acquired property, that the cost of removal and cleanup would not exceed the value of the property, or that the Bank could recover any of the costs from any third party. Losses arising from environmental liabilities could have a material adverse impact on the Corporation's business, financial condition, results of operations, or liquidity.

***Federal and state governments could pass legislation responsive to current credit conditions which could cause the Corporation to experience higher credit losses.***

The Corporation could experience higher credit losses because of federal or state legislation or regulatory action that reduces the amount the Bank's borrowers are otherwise contractually required to pay under existing loan contracts. Also, the Corporation could experience higher credit losses because of federal or state legislation or regulatory action that limits the Bank's ability to foreclose on property or other collateral or makes foreclosure less economically feasible. The Corporation cannot assure you that future legislation will not significantly and adversely impact its ability to collect on its current loans or foreclose on collateral.

***The preparation of the Corporation's financial statements requires the use of estimates that could significantly vary from actual results, which could have a material adverse effect on the Corporation's business, financial condition, results of operations or liquidity.***

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make significant estimates that affect the financial statements. For example, one of these significant estimates is the allowance for loan losses. Due to the inherent nature of estimates, the Corporation cannot provide absolute assurance that it will not

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significantly increase the allowance for loan losses and/or sustain credit losses that are significantly higher than the provided allowance, which could have a material adverse effect on the Corporation's business, financial condition, results of operations or liquidity.

***The Corporation's financial results may be subject to the impact of changes in accounting standards or interpretation in new or existing standards.***

From time to time the Financial Accounting Standards Board, or FASB, and the SEC change accounting regulations and reporting standards that govern the preparation of the Corporation's financial statements. In addition, the FASB, SEC, and bank regulators may revise their previous interpretations regarding existing accounting regulations and the application of these accounting standards. These revisions in their interpretations are out of the Corporation's control and may have a material impact on its financial statements.

***Customer information may be obtained and used fraudulently, which may negatively impact the Corporation's reputation and customer base, cause increased regulatory scrutiny and expose the Corporation to litigation.***

Risk of theft of customer information resulting from security breaches by third parties exposes the Corporation to reputation risk and potential monetary loss. CNB has exposure to fraudulent use of its customers' personal information resulting from its general business operations and through customer use of financial instruments such as debit cards. While CNB has policies and procedures designed to prevent or limit the effect of this risk, the Corporation cannot assure you that any such security breaches will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any security breaches could damage CNB's reputation, result in a loss of customer business, subject CNB to additional regulatory scrutiny, or expose CNB to civil litigation and possible financial liability, any of which could have a material adverse effect on CNB's financial condition and results of operations.

***The unsoundness of other financial institutions with which the Corporation does business could adversely affect the Corporation's business, financial condition or results of operations.***

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial institutions are interrelated as a result of trading, clearing, counterparty, investment or other relationships. The Corporation routinely executes transactions with counterparties in the financial services industry such as commercial banks, brokers and dealers, investment banks and other institutional clients for a range of transactions including loan participations, derivatives and hedging transactions. In addition, the Corporation invests in securities or loans originated or issued by financial institutions or supported by the loans they originate. As a result, defaults by, or even rumors or questions about, one or more financial institutions, or the financial industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or other institutions. Many of these transactions expose the Corporation to credit or investment risk in the event of default by the Corporation's counterparty. In addition, the Corporation's credit risk may be exacerbated if the collateral it holds cannot be realized or is liquidated at prices not sufficient to recover the full amount of the loan or other exposure to the Corporation. The Corporation could incur losses to its securities portfolio as a result of these issues. These types of losses may have a material adverse effect on the Corporation's business, financial condition or results of operation.



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*Some provisions contained in the Corporation's articles of incorporation and its bylaws and under Pennsylvania law could deter a takeover attempt or delay changes in control or management of the Corporation.*

Certain anti-takeover provisions of the Pennsylvania Business Corporation Law of 1988, as amended, apply to Pennsylvania registered corporations (e.g., publicly traded companies) including, but not limited to, those relating to (1) control share acquisitions, (2) disgorgement of profits by certain controlling persons, (3) business combination transactions with interested shareholders, and (4) the rights of shareholders to demand fair value for their stock following a control transaction. Pennsylvania law permits corporations to opt-out of these anti-takeover provisions, but the Corporation has not done so. Such provisions could have the effect of deterring takeovers or delaying changes in control or management of the Corporation. Additionally, such provisions could limit the price that some investors might be willing to pay in the future for shares of the Corporation's common stock.

For example, the Corporation's amended and restated articles of incorporation require the affirmative vote of 66% of the outstanding shares entitled to vote to effect a business combination. In addition, the Corporation's amended and restated articles of incorporation, subject to the limitations prescribed in such articles and subject to limitations prescribed by Pennsylvania law, authorize the Corporation's board of directors, from time to time by resolution and without further shareholder action, to provide for the issuance of shares of preferred stock, in one or more series, and to fix the designation, powers, preferences and other rights of the shares and to fix the qualifications, limitations and restrictions thereof. As a result of its broad discretion with respect to the creation and issuance of preferred stock without shareholder approval, the board of directors could adversely affect the voting power and other rights of the holders of common stock and, by issuing shares of preferred stock with certain voting, conversion and/or redemption rights, could discourage any attempt to obtain control of CNB.

The Corporation's bylaws, as amended and restated, provide for the division of the Corporation's board of directors into three classes of directors, with each serving staggered terms. In addition, any amendment to the Corporation's bylaws must be approved by the affirmative vote of a majority of the votes cast by all shareholders entitled to vote thereon and, if any shareholders are entitled to vote thereon as a class, upon receiving the affirmative vote of a majority of the votes cast by the shareholders entitled to vote as a class.

Any of the foregoing provisions may have the effect of deterring takeovers or delaying changes in control or management of the Corporation.

*The price of the Corporation's common stock may fluctuate significantly, and this may make it difficult for you to resell shares of common stock owned by you at times or at prices you find attractive.*

The price of the Corporation's common stock on the NASDAQ constantly changes. The Corporation expects that the market price of its common stock will continue to fluctuate, and the Corporation cannot give you any assurances regarding any trends in the market prices for its common stock.

The Corporation's stock price may fluctuate as a result of a variety of factors, many of which are beyond its control. These factors include the Corporation's:

- past and future dividend practice;
- financial condition, performance, creditworthiness and prospects;
- quarterly variations in the Corporation's operating results or the quality of the Corporation's assets;

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operating results that vary from the expectations of management, securities analysts and investors;  
changes in expectations as to the Corporation's future financial performance;  
announcements of innovations, new products, strategic developments, significant contracts, acquisitions and other material events by the Corporation or its competitors;  
the operating and securities price performance of other companies that investors believe are comparable to the Corporation;  
future sales of the Corporation's equity or equity-related securities;  
the credit, mortgage and housing markets, the markets for securities relating to mortgages or housing, and developments with respect to financial institutions generally; and  
instability in global financial markets and global economies and general market conditions, such as interest or foreign exchange rates, stock, commodity or real estate valuations or volatility, budget deficits or sovereign debt level concerns and other geopolitical, regulatory or judicial events.

*The Corporation's ability to pay dividends is limited by law and regulations.*

The future declaration of dividends by the Corporation's Board of Directors will depend on a number of factors, including capital requirements, regulatory limitations, the Corporation's operating results and financial condition and general economic conditions. The Corporation's ability to pay dividends depends primarily on the receipt of dividends from the Bank. Dividend payments from the Bank are subject to legal and regulatory limitations, generally based on retained earnings, imposed by bank regulatory agencies. The ability of the Bank to pay dividends is also subject to financial condition, regulatory capital requirements, capital expenditures and other cash flow requirements. The Corporation cannot assure you that the Bank will be able to pay dividends to CNB in the future. The Corporation may decide to limit the payment of dividends to its stockholders even when the Corporation has the legal ability to pay them in order to retain earnings for use in the Corporation's business.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None

**ITEM 2. PROPERTIES**

The headquarters of the Corporation and the Bank are located at 1 South Second Street, Clearfield, Pennsylvania, in a building owned by the Corporation. The Bank operates 28 full-service offices and 1 loan production office. Of these 29 offices, 21 are owned and 8 are leased from independent owners. Holiday Financial Services Corporation has ten full-service offices of which seven are leased from independent owners and three are leased from the Bank. There are no encumbrances on the offices owned and the rental expense on the leased property is immaterial in relation to operating expenses. The initial lease terms range from one to twenty years.

**ITEM 3. LEGAL PROCEEDINGS**

There are no material pending legal proceedings to which the Corporation or any of its subsidiaries is a party, or of which any of their property is the subject, except ordinary routine proceedings which are incidental to the business.

**ITEM 4. MINE SAFETY DISCLOSURES**

None

**Table of Contents****PART II.****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****Quarterly Share Data; Holders**

Our common stock is traded on the Global Select Market of The NASDAQ Stock Market LLC under the symbol CCNE. The following tables set forth, for the periods indicated, the quarterly high and low sales price of the Corporation's common stock as reported by the NASDAQ Global Select Market and actual cash dividends paid per share. As of December 31, 2012, the approximate number of shareholders of record of the Corporation's common stock was 3,604.

**Price Range of Common Stock**

|                | 2012     |          | 2011     |          |
|----------------|----------|----------|----------|----------|
|                | High     | Low      | High     | Low      |
| First quarter  | \$ 17.50 | \$ 14.59 | \$ 15.14 | \$ 13.51 |
| Second quarter | 17.32    | 14.24    | 14.50    | 12.38    |
| Third quarter  | 18.20    | 15.28    | 14.37    | 11.17    |
| Fourth quarter | 17.90    | 14.62    | 17.21    | 12.17    |

**Cash Dividends Paid**

|                | 2012     | 2011     |
|----------------|----------|----------|
| First quarter  | \$ 0.165 | \$ 0.165 |
| Second quarter | 0.165    | 0.165    |
| Third quarter  | 0.165    | 0.165    |
| Fourth quarter | 0.165    | 0.165    |

See Note 17 to the consolidated financial statements in Item 8 and Supervision and Regulation Dividend Restrictions in Part I, Item 1 for a discussion of dividend restrictions.

**Issuer Purchases of Equity Securities**

The following table provides information with respect to any purchase of shares of the Corporation's common stock made by or on behalf of the Corporation for the quarter ended December 31, 2012.

| Period                | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or approximate dollar value) of Shares that May Yet Be Purchased Under the Plans or Programs |
|-----------------------|----------------------------------|------------------------------|--|--|
| October 1 - 31, 2012  | -                                | -                            | -  | 168,386  |
| November 1 - 31, 2012 | -                                | -                            | -  | 168,386  |

|            |          |   |   |   |         |
|------------|----------|---|---|---|---------|
| December 1 | 31, 2012 | - | - | - | 168,386 |
|------------|----------|---|---|---|---------|

**Table of Contents****Performance Graph**

Set forth below is a chart comparing the Corporation's cumulative return to stockholders against the cumulative return of the NASDAQ Composite Index and a Peer Group Index of banking organizations for the five-year period commencing December 31, 2007 and ending December 31, 2012.

| <i>Index</i>              | <i>Period Ending</i> |          |          |          |          |          |
|---------------------------|----------------------|----------|----------|----------|----------|----------|
|                           | 12/31/07             | 12/31/08 | 12/31/09 | 12/31/10 | 12/31/11 | 12/31/12 |
| CNB Financial Corporation | 100.00               | 86.61    | 130.33   | 126.26   | 141.05   | 152.64   |
| NASDAQ Composite          | 100.00               | 60.02    | 87.24    | 103.08   | 102.26   | 120.42   |
| SNL Bank NASDAQ           | 100.00               | 72.62    | 58.91    | 69.51    | 61.67    | 73.51    |

Source : SNL Financial LC, Charlottesville, VA

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| (Dollars in thousands, except per share data)              | Year ended December 31, |                  |                  |                 |                 |
|--|-------------------------|------------------|------------------|-----------------|-----------------|
|  | 2012                    | 2011             | 2010             | 2009            | 2008            |
| <b>INTEREST AND DIVIDEND INCOME:</b>                       |                         |                  |                  |                 |                 |
| Loans including fees                                       | \$ 49,760               | \$ 48,324        | \$ 46,955        | \$ 45,839       | \$ 47,355       |
| Deposits with banks  | 3                       | 110              | 125              | 215             | 429             |
| Federal funds sold   | -                       | -                | -                | -               | 342             |
| <b>Securities:</b>   |                         |                  |                  |                 |                 |
| Taxable  | 14,685                  | 14,285           | 11,603           | 7,687           | 7,419           |
| Tax-exempt   | 3,595                   | 2,957            | 2,435            | 2,095           | 1,414           |
| Dividends  | 86                      | 36               | 29               | 34              | 224             |
| <b>Total interest and dividend income</b>                  | <b>68,129</b>           | <b>65,712</b>    | <b>61,147</b>    | <b>55,870</b>   | <b>57,183</b>   |
| <b>INTEREST EXPENSE:</b>                                   |                         |                  |                  |                 |                 |
| Deposits   | 10,875                  | 13,625           | 13,558           | 13,091          | 14,956          |
| Borrowed funds   | 3,245                   | 3,176            | 4,716            | 4,527           | 4,609           |
| Subordinated debentures                                    | 800                     | 778              | 782              | 850             | 1,018           |
| <b>Total interest expense</b>                              | <b>14,920</b>           | <b>17,579</b>    | <b>19,056</b>    | <b>18,468</b>   | <b>20,583</b>   |
| <b>NET INTEREST INCOME</b>                                 | <b>53,209</b>           | <b>48,133</b>    | <b>42,091</b>    | <b>37,402</b>   | <b>36,600</b>   |
| <b>PROVISION FOR LOAN LOSSES</b>                           | <b>6,381</b>            | <b>4,937</b>     | <b>5,158</b>     | <b>4,465</b>    | <b>3,787</b>    |
| <b>Net interest income after provision for loan losses</b> | <b>46,828</b>           | <b>43,196</b>    | <b>36,933</b>    | <b>32,937</b>   | <b>32,813</b>   |
| <b>NON-INTEREST INCOME</b>                                 | <b>12,664</b>           | <b>10,719</b>    | <b>9,650</b>     | <b>7,950</b>    | <b>2,168</b>    |
| <b>NON-INTEREST EXPENSES</b>                               | <b>35,945</b>           | <b>33,282</b>    | <b>31,798</b>    | <b>30,021</b>   | <b>28,479</b>   |
| <b>INCOME BEFORE INCOME TAXES</b>                          | <b>23,547</b>           | <b>20,633</b>    | <b>14,785</b>    | <b>10,866</b>   | <b>6,502</b>    |
| <b>INCOME TAX EXPENSE</b>                                  | <b>6,411</b>            | <b>5,529</b>     | <b>3,469</b>     | <b>2,354</b>    | <b>1,267</b>    |
| <b>NET INCOME</b>  | <b>\$ 17,136</b>        | <b>\$ 15,104</b> | <b>\$ 11,316</b> | <b>\$ 8,512</b> | <b>\$ 5,235</b> |
| <b>PER SHARE DATA:</b>                                     |                         |                  |                  |                 |                 |
| Basic  | \$ 1.38                 | \$ 1.23          | \$ 1.06          | \$ 0.98         | \$ 0.61         |
| Fully diluted  | 1.38                    | 1.23             | 1.06             | 0.98            | 0.61            |
| Dividends declared   | 0.66                    | 0.66             | 0.66             | 0.66            | 0.645           |
| Book value per share at year end                           | 11.65                   | 10.66            | 8.96             | 7.92            | 7.27            |
| <b>AT END OF PERIOD:</b>                                   |                         |                  |                  |                 |                 |
| Total assets   | \$ 1,773,079            | \$ 1,602,207     | \$ 1,413,511     | \$ 1,161,591    | \$ 1,016,518    |
| Securities   | 741,770                 | 641,340          | 503,028          | 347,748         | 238,181         |
| Loans, net of unearned discount                            | 927,824                 | 849,883          | 794,562          | 715,142         | 671,556         |
| Allowance for loan losses                                  | 14,060                  | 12,615           | 10,820           | 9,795           | 8,719           |
| Deposits   | 1,485,003               | 1,353,851        | 1,162,868        | 956,858         | 814,596         |

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|  |         |         |         |         |         |
|--|---------|---------|---------|---------|---------|
| FHLB and other borrowings              | 97,806  | 74,456  | 105,259 | 100,003 | 107,478 |
| Subordinated debentures                | 20,620  | 20,620  | 20,620  | 20,620  | 20,620  |
| Shareholders' equity                   | 145,364 | 131,889 | 109,645 | 69,409  | 62,467  |
| <b>KEY RATIOS:</b>                     |         |         |         |         |         |
| Return on average assets               | 1.00%   | 1.00%   | 0.87%   | 0.79%   | 0.55%   |
| Return on average equity               | 12.17%  | 12.36%  | 11.62%  | 12.86%  | 7.88%   |
| Loan to deposit ratio                  | 62.48%  | 62.78%  | 68.33%  | 74.74%  | 82.44%  |
| Dividend payout ratio                  | 47.93%  | 53.79%  | 61.27%  | 67.27%  | 105.53% |
| Average equity to average assets ratio | 8.22%   | 8.09%   | 7.46%   | 6.17%   | 7.00%   |

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**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis of the consolidated financial statements of CNB Financial Corporation (the Corporation) is presented to provide insight into management's assessment of financial results. The Corporation's subsidiary, CNB Bank (the Bank), provides financial services to individuals and businesses primarily within its primary market area of the Pennsylvania counties of Cambria, Cameron, Clearfield, Crawford, Elk, Erie, Indiana, McKean and Warren. The Bank's market area also includes a portion of western Centre County including Philipsburg Borough, Rush Township and the western portions of Snow Shoe and Burnside Townships and a portion of Jefferson County, consisting of the boroughs of Brockway, Falls Creek, Punxsutawney, Reynoldsville and Sykesville, and the townships of Washington, Winslow and Henderson. The Bank is subject to regulation, supervision and examination by the Pennsylvania State Department of Banking as well as the Federal Deposit Insurance Corporation. The financial condition and results of operations of the Corporation and its consolidated subsidiaries are not necessarily indicative of future performance. CNB Securities Corporation is incorporated in Delaware and currently maintains investments in debt and equity securities. County Reinsurance Company is an Arizona Corporation and provides credit life and disability insurance for customers of CNB Bank. CNB Insurance Agency, incorporated in Pennsylvania, provides for the sale of nonproprietary annuities and other insurance products. Holiday Financial Services Corporation (Holiday), incorporated in Pennsylvania, offers small balance unsecured loans and secured loans, primarily collateralized by automobiles and equipment, to borrowers with higher risk characteristics. Management's discussion and analysis should be read in conjunction with the audited consolidated financial statements and related notes.

Risk identification and management are essential elements for the successful management of the Corporation. In the normal course of business, the Corporation is subject to various types of risk, including interest rate, credit, and liquidity risk. These risks are controlled through policies and procedures established by the Corporation.

Interest rate risk is the sensitivity of net interest income and the market value of financial instruments to the direction and frequency of changes in interest rates. Interest rate risk results from various repricing frequencies and the maturity structure of the financial instruments owned by the Corporation. The Corporation uses its asset/liability management policy and systems to control, monitor and manage interest rate risk.

Credit risk represents the possibility that a customer may not perform in accordance with contractual terms. Credit risk results from loans to customers and the purchase of securities. The Corporation manages credit risk by following an established credit policy and using a disciplined evaluation of the adequacy of the allowance for loan losses. Also, the investment policy limits the amount of credit risk that may be taken in the securities portfolio.

Liquidity risk represents the inability to generate or otherwise obtain funds at reasonable rates to satisfy commitments to borrowers and obligations to depositors. The Corporation has established guidelines within its asset-liability management policy to manage liquidity risk. These guidelines include contingent funding alternatives.

**Forward-Looking Statements**

The information below includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as



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amended, with respect to the financial condition, liquidity, results of operations, future performance and our business. These forward-looking statements are intended to be covered by the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are those that are not historical facts. Forward-looking statements include statements with respect to beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions that are subject to significant risks and uncertainties and are subject to change based on various factors (some of which are beyond our control). Forward-looking statements often include the words believes, expects, anticipates, estimates, forecasts, intends, plans, targets, potentially, probably, projects, outlook or similar conditional verbs such as may, will, should, would and could. Such known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from the statements, include, but are not limited to, (i) changes in general business, industry or economic conditions or competition; (ii) changes in any applicable law, rule, regulation, policy, guideline or practice governing or affecting financial holding companies and their subsidiaries or with respect to tax or accounting principals or otherwise; (iii) adverse changes or conditions in capital and financial markets; (iv) changes in interest rates; (v) higher than expected costs or other difficulties related to integration of combined or merged businesses; (vi) the inability to realize expected cost savings or achieve other anticipated benefits in connection with business combinations and other acquisitions; (vii) changes in the quality or composition of our loan and investment portfolios; (viii) adequacy of loan loss reserves; (ix) increased competition; (x) loss of certain key officers; (xi) continued relationships with major customers; (xii) deposit attrition; (xiii) rapidly changing technology; (xiv) unanticipated regulatory or judicial proceedings and liabilities and other costs; (xv) changes in the cost of funds, demand for loan products or demand for financial services; and (xvi) other economic, competitive, governmental or technological factors affecting our operations, markets, products, services and prices. Such developments could have an adverse impact on our financial position and our results of operations.

The forward-looking statements contained herein are based upon management's beliefs and assumptions. Any forward-looking statement made herein speaks only as of the date on which it is made. Factors or events that could cause our actual results to differ may emerge from time to time, and it is not possible for us to predict all of them. We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by law.

## **General Overview**

The Bank expanded its ERIEBANK division by opening a second full service office in Meadville, Pennsylvania in the third quarter of 2012. In addition, a CNB Bank loan production office was opened in Indiana, Pennsylvania in the third quarter of 2011. A CNB Bank loan production office in Johnstown, Pennsylvania was closed in the third quarter of 2011. The Corporation also opened a ninth office for Holiday in Dubois, Pennsylvania in the third quarter of 2012. The Corporation also purchased a consumer discount company in Ebensburg, Pennsylvania during the third quarter of 2012, resulting in the acquisition of a loan portfolio of approximately \$1 million with a purchase premium of \$200 thousand. The Corporation is operating the acquired location as its tenth Holiday office. Management believes that our ERIEBANK market area, along with our traditional CNB Bank market areas, should provide the Bank with sustained loan growth during 2013. Deposit growth was significant in 2012 and 2011.

Management concentrates on return on average equity and earnings per share metrics, plus other metrics, to measure the performance of the Corporation. The interest rate environment will continue to

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play an important role in the future earnings of the Corporation. We experienced some compression of our net interest margin in 2012 and some additional compression is expected in 2013 as a result of the current interest rate environment. During the past several years, in order to address the historic lows on various key interest rates such as the Prime Rate and 3-month LIBOR, the Corporation has taken a variety of measures, including instituting rate floors on our commercial lines of credit and home equity lines. In addition, we decreased interest rates on certain deposit products during 2012 and 2011 but maintained deposit growth as a result of marketing a savings product which carries a highly competitive annual percentage yield. Non-interest costs are expected to increase with the growth of the Corporation. However, management's growth strategies are expected to increase earning assets as well as non-interest income which are expected to more than offset increases in non-interest expenses in 2013 and beyond. While past results are not an indication of future earnings, management believes the Corporation is well-positioned to sustain core earnings during 2013.

The Dodd-Frank Act, enacted into law on July 21, 2010, includes numerous provisions designed to strengthen the financial industry, enhance consumer protection, expand disclosures and provide for transparency, and significantly changed the bank regulatory structure and affected and will continue to affect the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act also created a Consumer Financial Protection Bureau (CFPB), which is authorized to write rules on a number of consumer financial products, and a Financial Services Oversight Council, which is empowered to determine which entities are systematically significant and require tougher regulations.

The Dodd-Frank Act requires various federal agencies to adopt a broad range of new rules and regulations, and to prepare various studies and reports for Congress.

It is difficult to predict at this time what specific impact certain provisions of the Dodd-Frank Act and the implementing rules and regulations, many which have yet to be written, will have on the Corporation, including any regulations promulgated by the CFPB. The legislation and any implementing rules that are ultimately issued could have adverse implications on the financial industry, the competitive environment, and the Corporation's ability to conduct business. The Corporation will have to apply resources to ensure that it is in compliance with all applicable provisions of the Dodd-Frank Act and any implementing rules, which may increase its costs of operations and adversely impact its earnings.

**Financial Condition**

The following table presents ending balances, growth, and the percentage change of certain measures of our financial condition for specified years (dollars in millions):

|                            | 2012<br>Balance | \$ Change<br>vs. prior<br>year | % Change<br>vs. prior<br>year | 2011<br>Balance | \$ Change<br>vs. prior<br>year | % Change<br>vs. prior<br>year | 2010<br>Balance |
|----------------------------|-----------------|--------------------------------|-------------------------------|-----------------|--------------------------------|-------------------------------|-----------------|
| Total assets               | \$ 1,773.1      | \$ 170.9                       | 10.7%                         | \$ 1,602.2      | \$ 188.7                       | 13.3%                         | \$ 1,413.5      |
| Total loans, net           | 913.8           | 76.5                           | 9.1                           | 837.3           | 53.6                           | 6.8                           | 783.7           |
| Total securities           | 741.7           | 100.4                          | 15.7                          | 641.3           | 138.3                          | 27.5                          | 503.0           |
| Total deposits             | 1,485.0         | 131.1                          | 9.7                           | 1,353.9         | 191.0                          | 16.4                          | 1,162.9         |
| Total shareholders' equity | 145.4           | 13.5                           | 10.2                          | 131.9           | 22.3                           | 20.3                          | 109.6           |

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### **Overview of Balance Sheet**

The increase in assets of 10.7% during 2012 was primarily the result of continued deposit growth, with corresponding investments in the loan and securities portfolios. Loan growth occurred in both the commercial and residential mortgage portfolios due to our competitive advantage in commercial lending and the historically low interest rates throughout 2012 which resulted in refinancing activity as well as new residential mortgage loans and home equity borrowings. Although the Corporation's loan growth was \$76.5 million, or 9.1%, for the year ended December 31, 2012, its deposit growth was even more significant as total deposits grew by \$131.1 million, or 9.7%, during 2012, resulting in the Corporation's purchase of available-for-sale securities with the excess liquidity.

### **Cash and Cash Equivalents**

Cash and cash equivalents totaled \$31.9 million at December 31, 2012 compared to \$39.7 million at December 31, 2011. Cash and cash equivalents fluctuate based on the timing and amount of liquidity events that occur in the normal course of business. We believe the year end balance to be adequate to support our expected funding needs in the short term.

We believe the liquidity needs of the Corporation are satisfied by the current balance of cash and cash equivalents, readily available access to traditional funding sources, Federal Home Loan Bank financing, and the portion of the securities and loan portfolios that matures within one year. These sources of funds will enable the Corporation to meet cash obligations and off-balance sheet commitments as they come due.

### **Securities**

Securities available for sale and trading securities have combined to increase \$100.4 million, or 15.7%, at December 31, 2012 when compared to December 31, 2011. The increase is primarily due to purchases of securities issued by U.S. government sponsored entities and state and local political subdivisions, and resulted from excess deposit growth not reinvested in loans. Note 3 to the consolidated financial statements provides more detail concerning the composition of the Corporation's securities portfolio, the process for evaluating securities for other-than-temporary impairment, and for valuation of structured pooled trust preferred securities.

The Corporation generally buys into the market over time and does not attempt to time its transactions. In doing this, the highs and lows of the market are averaged into the portfolio and the overall effect of different rate environments is minimized. The Corporation monitors the earnings performance and the effectiveness of the liquidity of the securities portfolio on a regular basis through meetings of the Asset/Liability Committee of the Corporation's Board of Directors (ALCO). The ALCO also reviews and manages interest rate risk for the Corporation. Through active balance sheet management and analysis of the securities portfolio, we maintain a sufficient level of liquidity to satisfy depositor requirements and various credit needs of our customers.

### **Loans**

The Corporation's lending is focused in the west central and northwest Pennsylvania markets and consists principally of commercial and retail lending, which includes single family residential mortgages and other consumer loans.

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As detailed in the table below, at December 31, 2012, the Corporation had \$927.8 million in loans outstanding, net of unearned discount, an increase of \$77.9 million (or 9.2%) since December 31, 2011. The increase was primarily the result of two factors. The first factor was increasing demand for commercial mortgage loans. The Corporation views commercial lending as its competitive advantage and continues to focus on this area by hiring and retaining experienced loan officers and supporting them with quality credit analysis. The second factor was increasing demand for residential mortgage loan products due to historically low interest rates throughout 2012, resulting in both refinancing activity as well as new mortgage loans and home equity borrowings.

| (dollars in thousands)                   | 2012       | 2011       |
|--|------------|------------|
| Commercial, industrial, and agricultural | \$ 257,091 | \$ 253,324 |
| Commercial mortgages                     | 261,791    | 242,511    |
| Residential real estate                  | 347,904    | 298,628    |
| Consumer                                 | 58,668     | 53,471     |
| Credit cards                             | 4,800      | 4,412      |
| Overdrafts                               | 971        | 423        |
| Less: unearned discount                  | (3,401)    | (2,886)    |
| Total loans, net of unearned discount    | \$ 927,824 | \$ 849,883 |

With continued economic improvement in our market areas, the Corporation expects loan demand in 2013 to be consistent with 2012.

**Loan Concentration**

The Corporation monitors loan concentrations by individual industries in order to track potential risk exposures resulting from industry related downturns. At December 31, 2012, no concentration existed within our commercial or real estate loan portfolio that exceeded 10% of the total loans.

**Loan Quality**

The Corporation has established written lending policies and procedures that require underwriting standards, loan documentation, and credit analysis standards to be met prior to funding a loan. Subsequent to the funding of a loan, ongoing review of credits is required. Credit reviews are performed annually on a minimum of 65% of the commercial loan portfolio by an outsourced loan review firm. In addition, classified assets, past due loans and nonaccrual loans are reviewed by the loan review partner semiannually and monthly by our credit administration staff.

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The following table presents information concerning loan delinquency and other non-performing assets at December 31, 2012, 2011, and 2010 (dollars in thousands):

|  | 2012             | 2011             | 2010             |
|--|------------------|------------------|------------------|
| Non-accrual loans                                      | \$ 14,445        | \$ 16,567        | \$ 11,926        |
| Accrual loans greater than 89 days past due            | 357              | 441              | 889              |
| <b>Total nonperforming loans</b>                       | <b>14,802</b>    | <b>17,008</b>    | <b>12,815</b>    |
| Other real estate owned                                | 325              | 505              | 396              |
| <b>Total nonperforming assets</b>                      | <b>\$ 15,127</b> | <b>\$ 17,513</b> | <b>\$ 13,211</b> |
| Loans modified in a troubled debt restructuring (TDR): |                  |                  |                  |
| Performing TDR loans                                   | \$ 9,961         | \$ 7,688         | \$ 1,714         |
| Non-performing TDR loans *                             | 1,660            | -                | -                |
| <b>Total TDR loans</b>                                 | <b>\$ 11,621</b> | <b>\$ 7,688</b>  | <b>\$ 1,714</b>  |
| Total loans, net of unearned income                    | \$ 927,824       | \$ 849,883       | \$ 794,562       |
| Nonperforming loans as a percentage of loans, net      | 1.60%            | 2.00%            | 1.61%            |
| Total assets   | \$ 1,773,079     | \$ 1,602,207     | \$ 1,413,511     |
| Nonperforming assets as a percentage of total assets   | 0.85%            | 1.09%            | 0.93%            |

\* Nonperforming TDR loans are also included in the balance of non-accrual loans in the previous table.

Management continues to closely monitor nonperforming loans, and the Corporation's nonperforming loans to total loans ratio continues to be favorable compared to peer institutions. See the Allowance for Loan Losses section for further discussion of credit review procedures and changes in nonperforming loans.

**Allowance for Loan Losses**

The allowance for loan losses is established by provisions for losses in the loan portfolio as well as overdrafts in deposit accounts. These provisions are charged against current income. Loans and overdrafts deemed not collectible are charged off against the allowance while any subsequent collections are recorded as recoveries and increase the allowance.

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The following table presents activity within the allowance for loan losses during the years ended December 31, 2012, 2011, and 2010 (dollars in thousands):

|  | 2012       | 2011       | 2010       |
|--|------------|------------|------------|
| Balance at beginning of period           | \$ 12,615  | \$ 10,820  | \$ 9,795   |
| Charge-offs:                             |            |            |            |
| Commercial, industrial, and agricultural | 2,871      | 1,796      | 543        |
| Commercial mortgages                     | 401        | 175        | 2,061      |
| Residential real estate                  | 304        | 217        | 211        |
| Consumer                                 | 1,279      | 907        | 1,223      |
| Credit cards                             | 78         | 39         | 94         |
| Overdrafts                               | 257        | 222        | 239        |
|  | 5,190      | 3,356      | 4,371      |
| Recoveries:                              |            |            |            |
| Commercial, industrial, and agricultural | 45         | 9          | 11         |
| Commercial mortgages                     | -          | -          | 3          |
| Residential real estate                  | 1          | 13         | 2          |
| Consumer                                 | 91         | 88         | 100        |
| Credit cards                             | 18         | 10         | 10         |
| Overdrafts                               | 99         | 94         | 112        |
|  | 254        | 214        | 238        |
| Net charge-offs                          | (4,936)    | (3,142)    | (4,133)    |
| Provision for loan losses                | 6,381      | 4,937      | 5,158      |
| Balance at end of period                 | \$ 14,060  | \$ 12,615  | \$ 10,820  |
| Loans, net of unearned income            | \$ 927,824 | \$ 849,883 | \$ 794,562 |
| Allowance to net loans                   | 1.52%      | 1.48%      | 1.36%      |

The adequacy of the allowance for loan losses is subject to a formal analysis by the credit administrator of the Corporation. As part of the formal analysis, delinquencies and losses are monitored monthly. The loan portfolio is divided into several categories in order to better analyze the entire pool. First, impaired loans are selected and that group of loans is given a specific reserve. The remaining loans are pooled, by category, into these segments:

**Reviewed**

Commercial, industrial, and agricultural  
Commercial mortgages

**Homogeneous**

Residential real estate  
Consumer  
Credit cards  
Overdrafts

The reviewed loan pools are further segregated into three categories: special mention, substandard, and doubtful. Historical loss factors are calculated for each reviewed pool, excluding overdrafts, based on the previous eight quarters of experience. The homogeneous pools are evaluated by analyzing the historical loss factors from the most previous quarter end and the two most recent year ends.



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The historical loss factors for both the reviewed and homogeneous pools are adjusted based on these six qualitative factors:

- levels of and trends in delinquencies, non-accrual loans, and classified loans;
- trends in volume and terms of loans;
- effects of any changes in lending policies and procedures;
- experience, ability and depth of management;
- national and local economic trends and conditions; and
- concentrations of credit.

The methodology described above was created using the experience of our credit administrator, guidance from the regulatory agencies, expertise of our third party loan review provider, and discussions with our peers. The resulting factors are applied to the pool balances in order to estimate the probable risk of loss within each pool. As a result of the application of these procedures, the allocation of the allowance for loan losses was as follows at December 31, 2012, 2011 and 2010 (in thousands):

|   | 2012             | 2011             | 2010             |
|---|------------------|------------------|------------------|
| Commercial, industrial and agricultural | \$ 4,940         | \$ 4,511         | \$ 3,517         |
| Commercial mortgages                    | 4,697            | 4,470            | 3,511            |
| Residential real estate                 | 2,466            | 1,991            | 1,916            |
| Consumer                                | 1,699            | 1,404            | 1,561            |
| Credit cards                            | 83               | 71               | 96               |
| Overdrafts                              | 175              | 168              | 219              |
| <b>Total</b>                            | <b>\$ 14,060</b> | <b>\$ 12,615</b> | <b>\$ 10,820</b> |

Throughout 2012, the Corporation evaluated its provision and allowance for loan losses in light of changes in reserves required for impaired loans, changes in nonperforming loans, and growth in loans outstanding. Note 4 to the consolidated financial statements provides further disclosure of loan balances by portfolio segment as of December 31, 2012 and 2011, as well as the nature and scope of loans modified in a troubled debt restructuring during 2012 and 2011 and the related effect on the provision and allowance for loan losses.

In May 2012, CNB management determined that one relationship comprising a commercial and industrial loan of \$2.4 million and two consumer loans totaling \$200 thousand had become impaired. CNB charged off the balances of the consumer loans and recorded a specific allocation of \$1.1 million for the commercial loan based on CNB's evaluation of the estimated present value of future cash flows. As a result, the provision for loan losses increased by \$1.3 million. CNB charged off \$750 thousand related to the commercial loan in the third quarter of 2012. In September 2012, one relationship comprising two commercial mortgage loans totaling \$1.7 million that had previously been modified in a troubled debt restructuring defaulted under its restructured terms, resulting in an increase in the provision for loan losses of \$503 thousand. It is possible that further deterioration with respect to these loan relationships may occur in the future.

In October 2012, an impaired commercial loan was partially repaid, resulting in an additional chargeoff of \$109 thousand and a reduction in nonperforming assets of \$1.8 million.



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In December 2012, one impaired commercial and industrial loan with a balance of \$1.4 million was charged off. As of September 30, 2012, a workout agreement with the borrower was probable, which would have resulted in no loss to CNB. As a result, no specific reserve was recorded as of the end of the third quarter of 2012. In December, CNB obtained new information from the borrower and determined that the likelihood of a workout agreement or any future payments from the borrower was remote. Therefore, the loan was charged off and the provision for loan losses was increased by \$1.4 million.

Finally, the effect of increases in net chargeoffs in 2012, 2011, 2010, and 2009, as compared to net chargeoffs in 2008, as disclosed in the Summary of Loan Loss Experience table in Item 1, as well as the increase in the Corporation's loan portfolio in 2012, had a significant impact on the loan loss reserves required for homogeneous loan pools during the year ended December 31, 2012. As disclosed in Note 4 to the consolidated financial statements, the allowance for loan loss balance attributable to loans collectively evaluated for impairment increased from \$11.1 million at December 31, 2011 to \$12.2 million at December 31, 2012.

Prudent business practices dictate that the level of the allowance, as well as corresponding charges to the provision for loan losses, should be commensurate with identified areas of risk within the loan portfolio and the attendant risks inherent therein. The quality of the credit risk management function and the overall administration of this vital segment of the Corporation's assets are critical to the ongoing success of the Corporation.

The previously mentioned analysis considered numerous historical and other factors to analyze the adequacy of the allowance and charges against the provision for loan losses. Management paid special attention to a section of the analysis that compared and plotted the actual level of the allowance against the aggregate amount of loans adversely classified in order to compute the estimated probable losses associated with those loans. By noting the spread at that time, as well as prior periods, management can evaluate the current adequacy of the allowance as well as evaluate trends that may be developing. The volume and composition of the Corporation's loan portfolio continue to reflect growth in commercial credits including commercial real estate loans.

As mentioned in the Loans section of this analysis, management considers commercial lending a competitive advantage and continues to focus on this area as part of its strategic growth initiatives. However, management must also consider the fact that the inherent risk is more pronounced in these types of credits and is also driven by the economic environment of its market areas.

Management believes that both its 2012 provision and allowance for loan losses were reasonable and adequate to absorb probable incurred losses in its portfolio at December 31, 2012.

## **Bank Owned Life Insurance**

The Corporation has periodically purchased Bank Owned Life Insurance ( BOLI ). The policies cover executive officers and a select group of other employees with the Bank being named as beneficiary. Earnings from the BOLI assist the Corporation in offsetting its benefit costs. During the third quarter of 2012, additional BOLI of \$1.0 million was purchased.

**Table of Contents****Funding Sources**

Although the Corporation considers short-term borrowings and long-term debt when evaluating funding sources, traditional deposits continue to be the main source for funding. As noted in the following table, traditional deposits increased 9.7% during 2012.

|                              | Percentage change<br>2012 vs.<br>2011 | Percentage change<br>2011 vs.<br>2010 | 2012                | 2011                | 2010                |
|------------------------------|---------------------------------------|---------------------------------------|---------------------|---------------------|---------------------|
| Demand, Non interest bearing | 14.7%                                 | 8.4%                                  | \$ 175,239          | \$ 152,732          | \$ 140,836          |
| Demand, Interest bearing     | 10.1%                                 | 7.5%                                  | 336,911             | 305,960             | 284,538             |
| Savings deposits             | 21.2%                                 | 70.4%                                 | 759,910             | 627,106             | 368,055             |
| Time deposits                | (20.6%)                               | (27.4%)                               | 212,943             | 268,053             | 369,439             |
| <b>Total</b>                 | <b>9.7%</b>                           | <b>16.4%</b>                          | <b>\$ 1,485,003</b> | <b>\$ 1,353,851</b> | <b>\$ 1,162,868</b> |

The growth in deposits was primarily due to increases in savings accounts of \$132.8 million from December 31, 2011 to December 31, 2012 as a result of the Corporation's marketing of a savings product which carries an annual percentage yield which is highly competitive in the current interest rate environment. This increase in savings accounts was offset by an expected decrease in time deposits of \$55.1 million as customers who previously held certificates of deposit migrated to the savings product.

Periodically, the Corporation utilizes term borrowings from the Federal Home Loan Bank (FHLB) and other lenders to meet funding obligations or match fund certain loan assets. The terms of these borrowings are detailed in Note 10 to the consolidated financial statements.

**Shareholders Equity and Capital Ratios and Metrics**

The Corporation's capital continues to provide a base for profitable growth. In 2012, the Corporation earned \$17.1 million and declared dividends of \$8.2 million, resulting in a dividend payout ratio of 47.9% of net income.

The Corporation has complied with the standards of capital adequacy mandated by government regulations. Bank regulators have established risk-based capital requirements designed to measure capital adequacy. Risk-based capital ratios reflect the relative risks of various assets banks hold in their portfolios. A weight category of 0% (lowest risk assets), 20%, 50%, or 100% (highest risk assets), is assigned to each asset on the balance sheet. The Corporation's capital ratios and book value per common share at December 31, 2012 and 2011 are as follows:

|  | 2012     | 2011     |
|--|----------|----------|
| Total risk-based capital ratio             | 15.28%   | 15.14%   |
| Tier 1 capital ratio                       | 14.03%   | 13.89%   |
| Leverage ratio                             | 8.06%    | 8.22%    |
| Tangible common equity/tangible assets (1) | 7.63%    | 7.61%    |
| Book value per share                       | \$ 11.65 | \$ 10.66 |
| Tangible book value per share (1)          | 10.77    | 9.78     |

(1) Tangible common equity, tangible assets and tangible book value per share are non-GAAP financial measures calculated using GAAP amounts. Tangible common equity is calculated by excluding the balance of goodwill and other intangible assets from the calculation of stockholders

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equity. Tangible assets is calculated by excluding the balance of goodwill and other intangible assets from the calculation of total assets. Tangible book value per share is calculated by dividing tangible common equity by the number of shares outstanding. The Corporation believes that these non-GAAP financial measures provide information to investors that is useful in understanding its financial condition. Because not all companies use the same calculation of tangible common equity and tangible assets, this presentation may not be comparable to other similarly titled measures calculated by other companies. A reconciliation of these non-GAAP financial measures is provided below (dollars in thousands, except per share data).

|  | December 31,<br>2012 | December 31,<br>2011 |
|--|----------------------|----------------------|
| Shareholders' equity                   | \$ 145,364           | \$ 131,889           |
| Less goodwill                          | 10,946               | 10,821               |
| <b>Tangible common equity</b>          | <b>\$ 134,418</b>    | <b>\$ 121,068</b>    |
| Total assets                           | \$ 1,773,079         | \$ 1,602,207         |
| Less goodwill                          | 10,946               | 10,821               |
| <b>Tangible assets</b>                 | <b>\$ 1,762,133</b>  | <b>\$ 1,591,386</b>  |
| Ending shares outstanding              | 12,475,904           | 12,377,318           |
| Tangible book value per share          | \$ 10.77             | \$ 9.78              |
| Tangible common equity/tangible assets | 7.63%                | 7.61%                |

**Liquidity**

Liquidity measures an organization's ability to meet its cash obligations as they come due. The consolidated statements of cash flows included in the accompanying financial statements provide analysis of the Corporation's cash and cash equivalents and the sources and uses of cash. Additionally, the portion of the loan portfolio that matures within one year and securities with maturities within one year in the investment portfolio are considered part of the Corporation's liquid assets. Liquidity is monitored by both management and the Board's ALCO, which establishes and monitors ranges of acceptable liquidity. Also, the Bank is a member of FHLB which provides the Bank with a total borrowing line of approximately \$422 million with approximately \$358 million available at December 31, 2012. Management believes that the Corporation's current liquidity position is acceptable.

**Year Ended December 31, 2012 vs. Year Ended December 31, 2011**Overview of the Income Statement

The Corporation had net income of \$17.1 million for 2012 compared to \$15.1 million for 2011. The increase in net income is attributable to an increase in net interest income of \$5.1 million, or 10.5%, as well as an increase in non-interest income of \$1.8 million, or 17.2%. The provision for loan losses increased by \$1.4 million, or 29.2%, and non-interest expenses increased by \$2.7 million, or 8.0%, from 2012 to 2011. The earnings per diluted share increased from \$1.23 in 2011 to \$1.38 in 2012. The return on assets and the return on equity for 2012 are 1.00% and 12.17% as compared to 1.00% and 12.36% for 2011.

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### Interest Income and Expense

Net interest margin on a fully tax equivalent basis was 3.49% for the year ended December 31, 2012, compared to 3.59% for the year ended December 31, 2011. Total interest and dividend income increased by \$2.4 million, or 3.7%, as compared to 2011. Although the Corporation's earning assets continue to grow, these increases have been offset by decreases in the yield on earning assets as a result of the current interest rate environment. The Corporation's average earning assets increased by \$209.6 million for the year ended December 31, 2012 while the yield during that time decreased by 42 basis points from 4.84% to 4.42%. Total interest expense decreased \$2.7 million, or 15.1%, for the year ended December 31, 2012 as compared to the comparable period in 2011 as a result of the Corporation's focus on deposit mix and active management of deposit rates. The cost of interest bearing deposits decreased by 37 basis points which offset the increase in average interest bearing deposits of \$162.8 million.

### Provision for Loan Losses

The Corporation recorded a provision for loan losses of \$6.4 million in 2012 compared to \$4.9 million in 2011. Net loan chargeoffs were \$4.9 million during the year ended December 31, 2012 compared to \$3.1 million during the year ended December 31, 2011. As disclosed in the Allowance for Loan Losses section of Management's Discussion and Analysis, the Corporation increased the provision for loan losses as a result of management's evaluation of impaired loans as well as an evaluation of general reserves required for loans that are not impaired.

Management believes the charges to the provision in 2012 are appropriate and the allowance for loan losses is adequate to absorb probable incurred losses in our portfolio as of December 31, 2012.

### Non-Interest Income

Excluding the effects of the securities transactions described below, non-interest income was \$10.7 million for the year ended December 31, 2012, compared to \$10.4 million for the year ended December 31, 2011. Net realized gains on available-for-sale securities were \$1.4 million during the year ended December 31, 2012, compared to \$614 thousand during the year ended December 31, 2011. Net realized and unrealized gains on securities for which fair value was elected were \$461 thousand and \$64 thousand during the years ended December 31, 2012 and 2011, respectively. An other-than-temporary impairment charge of \$398 thousand was recorded in earnings on structured pooled trust preferred securities during the year ended December 31, 2011.

### Non-Interest Expense

Total non-interest expenses increased \$2.7 million, or 8.0%, during the year ended December 31, 2012 compared to the year ended December 31, 2011. Salaries and employee benefit expenses combined to increase \$1.6 million, or 9.3%, during the year ended December 31, 2012 compared to the year ended December 31, 2011, in part due to routine merit increases, an increase in full-time equivalent employees from 300 at December 31, 2011 to 323 at December 31, 2012, and increases in certain employee benefit expenses, such as health insurance costs, which continue to increase in line with market conditions. The remaining non-interest expenses increased \$1.1 million, or 6.6%, as a result of CNB's continued growth.

Total non-interest expenses on an annualized basis in relation to CNB's average asset size declined from 2.20% for the year ended December 31, 2011 to 2.10% for the year ended December 31, 2012.

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**Year Ended December 31, 2011 vs. Year Ended December 31, 2010**

**Overview of the Income Statement**

The Corporation had net income of \$15.1 million for 2011 compared to \$11.3 million for 2010. The increase in net income is attributable to an increase in net interest income of \$6.0 million, or 14.4%, as well as an increase in non-interest income of \$1.1 million, or 11.1%. The earnings per diluted share increased from \$1.06 in 2010 to \$1.23 in 2011. The return on assets and the return on equity for 2011 are 1.00% and 12.36% as compared to 0.87% and 11.62% for 2010.

**Interest Income and Expense**

Net interest margin on a fully tax equivalent basis was 3.59% for the year ended December 31, 2011, compared to 3.65% for the year ended December 31, 2010. Total interest and dividend income increased by \$4.6 million, or 7.5%, as compared to 2010. Although the Corporation's earning assets continued to grow in 2011, these increases were offset by decreases in the yield on earning assets as a result of the interest rate environment. The Corporation's average earning assets increased by \$203.3 million for the year ended December 31, 2011 while the yield during that time decreased by 66 basis points from 5.23% to 4.84%. Total interest expense decreased \$1.5 million, or 7.8%, for the year ended December 31, 2011 as compared to the comparable period in 2010 due in part to the Corporation's repayment and refinancing of long-term debt in 2010. In addition, as a result of the Corporation's focus on deposit mix and active management of deposit rates, the cost of interest bearing deposits decreased by 20 basis points which offset the increase in average interest bearing deposits of \$164.0 million.

The Corporation's interest expense on borrowings was negatively impacted by a \$707 thousand prepayment penalty that was recorded in the fourth quarter of 2010 when management elected to prepay a long-term borrowing having a fixed interest rate of 5.63%. The effect of this prepayment penalty was to reduce the net interest margin by 6 basis points for the year ended December 31, 2010.

**Provision for Loan Losses**

The Corporation recorded a provision for loan losses of \$4.9 million in 2011 compared to \$5.2 million in 2010. Net loan chargeoffs were \$3.1 million during the year ended December 31, 2011 compared to \$4.1 million during the year ended December 31, 2010. However, the Corporation significantly increased its general reserve for both commercial, industrial, and agricultural loans and commercial loans during 2011. In combination, these factors resulted in a slightly lower provision for loan losses in 2011 compared to 2010. Management believes the charges to the provision in 2011 were appropriate.

**Non-Interest Income**

Net realized securities gains during the year ended December 31, 2011 were \$614 thousand, compared to net realized securities gains of \$1.7 million for the year ended December 31, 2010. During the years ended December 31, 2011 and 2010, other-than-temporary impairment charges of \$398 thousand and \$2.2 million, respectively, were recorded in earnings on structured pooled trust preferred securities. In addition, the Corporation recorded realized and unrealized gains during the years ended December 31, 2011 and 2010 of \$64 thousand and \$162 thousand, respectively, for securities for which the fair value option was elected.

Excluding the effects of securities transactions, non-interest income was \$10.4 million for the year ended December 31, 2011, compared to \$10.1 million for the year ended December 31, 2010.

**Table of Contents****Non-Interest Expense**

Total non-interest expenses increased \$1.5 million, or 4.7%, during the year ended December 31, 2011 compared to the year ended December 31, 2010. Salaries and employee benefit expenses combined to increase \$1.6 million, or 10.2%, during the year ended December 31, 2011 compared to the year ended December 31, 2010, in part due to an increase in average full-time equivalent employees from 288 in 2010 to 297 in 2011. In addition, certain employee benefit expenses, such as health insurance premiums, continued to increase in line with market conditions.

FDIC insurance expenses decreased \$360 thousand, or 22.2%, during the year ended December 31, 2011 compared to the year ended December 31, 2010 due to the change in the FDIC insurance calculation from a deposit based formula to a tangible assets based formula in the second quarter of 2011.

**Income Tax Expense**

Income taxes were \$6.3 million in 2012, compared to \$5.5 million in 2011 and \$3.5 million in 2010. The effective tax rates were 26.9%, 26.8%, and 23.5% for 2012, 2011 and 2010, respectively. The effective tax rate for the periods differed from the federal statutory rate of 35.0% principally as a result of tax-exempt income from securities and loans as well as earnings from bank owned life insurance. The increase in the effective tax rate from 2010 to 2011 and 2012 is attributable to a lower percentage of tax-exempt income in 2012 and 2011 compared to pre-tax income.

**Contractual Obligations and Commitments**

The Corporation has various financial obligations, including contractual obligations and commitments that may require future cash payments. The following table presents, as of December 31, 2012, significant fixed and determinable contractual obligations to third parties by payment date. Further discussion of the nature of each obligation is included in the referenced note to the consolidated financial statements.

| (dollars in thousands)             | Note Reference | Payments Due In  |                    |                     |                 | Total        |
|------------------------------------|----------------|------------------|--------------------|---------------------|-----------------|--------------|
|                                    |                | One Year or Less | One to Three Years | Three to Five Years | Over Five Years |              |
| Deposits without a stated maturity |                | \$ 1,272,060     | 0                  | 0                   | 0               | \$ 1,272,060 |
| Certificates of deposit            | 9              | 71,033           | 94,287             | 35,987              | 11,636          | 212,943      |
| FHLB and other borrowings          | 10             | 23,677           | 20,358             | 50,390              | 3,381           | 97,806       |
| Operating leases                   | 6              | 402              | 717                | 587                 | 1,209           | 2,915        |
| Sale-leaseback                     | 6              | 112              | 224                | 224                 | 1,005           | 1,565        |
| Subordinated debentures            | 10             | 0                | 0                  | 0                   | 20,620          | 20,620       |

The Corporation's operating lease obligations represent short and long-term lease and rental payment for facilities. The Corporation's sale-leaseback obligation represents a long-term real estate lease associated with one of the Corporation's branch office locations.

The Corporation also has obligations under its postretirement plan for health care and supplemental executive retirement plan as described in Note 13 to the consolidated financial statements. The postretirement benefit payments represent actuarially determined future benefit payments to eligible plan participants. The supplemental executive retirement plan allocates expenses over the participant's service period. The Corporation reserves the right to terminate these plans at any time.

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### **Off-Balance Sheet Arrangements**

See Note 18 to the consolidated financial statements for information about our off-balance sheet arrangements.

### **Applications of Critical Accounting Policies**

The Corporation's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the U.S. and follow general practices within the industries in which the Corporation operates. Application of these principles requires management to make estimates or judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates or judgments. Certain policies inherently have a greater reliance on the use of estimates, and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates or judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third party sources, when available. When third-party information is not available, valuation adjustments are estimated in good faith by management primarily through the use of internal cash flow modeling techniques.

The most significant accounting policies used by the Corporation are presented in Note 1 to the consolidated financial statements. These policies, along with the disclosures presented in the other financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Management views critical accounting policies to be those which are highly dependent on subjective or complex judgments, estimates and assumptions, and where changes in those estimates and assumptions could have a significant impact on the financial statements.

A material estimate that is susceptible to significant change is the determination of the allowance for loan losses. The Corporation's methodology for determining the allowance for loan losses is described previously in Management's Discussion and Analysis. Given the subjective nature of identifying and valuing loan losses, it is likely that well-informed individuals could make materially different assumptions and could therefore calculate a materially different allowance value. While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in future years. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize adjustments to the allowance based on their judgments of information available to them at the time of their examination.

Another material estimate is the calculation of fair values of the Corporation's debt securities. For most of the Corporation's debt securities, the Corporation receives estimated fair values from an independent valuation service or from brokers. In developing fair values, the valuation service and the brokers use estimates of cash flows, based on historical performance of similar instruments in similar interest rate environments. Based on experience, management is aware that estimated fair values of debt securities tend to vary among brokers and other valuation services.

**Table of Contents****ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

As a financial institution, the Corporation's primary source of market risk is interest rate risk, which is the exposure to fluctuations in the Corporation's future earnings resulting from changes in interest rates. This exposure is correlated to the repricing characteristics of the Corporation's portfolio of assets and liabilities. Each asset or liability reprices either at maturity or during the life of the instrument.

The principal purpose of asset/liability management is to maximize current and future net interest income within acceptable levels of interest rate risk while satisfying liquidity and capital requirements. Net interest income is enhanced by increasing the net interest margin and by the growth in earning assets. As a result, the primary goal of interest rate risk management is to maintain a balance between risk and reward such that net interest income is maximized while risk is maintained at an acceptable level.

The Corporation uses an asset-liability management model to measure the effect of interest rate changes on its net interest income. The Corporation's management also reviews asset-liability maturity gap and repricing analyses regularly. The Corporation does not always attempt to achieve a precise match between interest sensitive assets and liabilities because it believes that an actively managed amount of interest rate risk is inherent and appropriate in the management of the Corporation's profitability.

Asset-liability modeling techniques and simulation involve assumptions and estimates that inherently cannot be measured with precision. Key assumptions in these analyses include maturity and repricing characteristics of assets and liabilities, prepayments on amortizing assets, non-maturing deposit sensitivity, and loan and deposit pricing. These assumptions are inherently uncertain due to the timing, magnitude, and frequency of rate changes and changes in market conditions and management strategies, among other factors. However, the analyses are useful in quantifying risk and provide a relative gauge of the Corporation's interest rate risk position over time.

Management reviews interest rate risk on a quarterly basis and reports to the ALCO. This review includes earnings shock scenarios whereby interest rates are immediately increased and decreased by 100, 300, and 400 basis points. These scenarios, detailed in the table below, indicate that there would not be a significant variance in net interest income over a one-year period due to interest rate changes; however, actual results could vary significantly. At December 31, 2012 and 2011, all interest rate risk levels according to the model were within the tolerance limits of ALCO approved policy of +/- 25%. In addition, the table does not take into consideration changes that management would make to realign its assets and liabilities in the event of an unexpected changing interest rate environment. Due to the historically low interest rate environment, the -300 and -400 scenarios have been excluded from the table.

| Change in<br>Basis Points | December 31, 2012            |                                       | December 31, 2011            |                                       |
|---------------------------|------------------------------|---------------------------------------|------------------------------|---------------------------------------|
|                           | Change in<br>Basis<br>Points | % Change in Net<br>Interest<br>Income | Change in<br>Basis<br>Points | % Change in Net<br>Interest<br>Income |
| 400                       |                              | -0.5%                                 | 400                          | -2.3%                                 |
| 300                       |                              | 0.8%                                  | 300                          | -0.1%                                 |
| 100                       |                              | 2.3%                                  | 100                          | 1.5%                                  |
| (100)                     |                              | -4.0%                                 | (100)                        | -5.5%                                 |



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## CONSOLIDATED BALANCE SHEETS

Dollars in thousands

|   | December 31, |              |
|---|--------------|--------------|
|   | 2012         | 2011         |
| <b><u>ASSETS</u></b>  |              |              |
| Cash and due from banks   | \$ 28,570    | \$ 36,032    |
| Interest bearing deposits with other banks  | 3,311        | 3,671        |
| Total cash and cash equivalents   | 31,881       | 39,703       |
| Interest bearing time deposits with other banks                                     | 225          | 224          |
| Securities available for sale   | 737,311      | 638,107      |
| Trading securities  | 4,459        | 3,233        |
| Loans held for sale   | 2,398        | 1,442        |
| Loans   | 931,225      | 852,769      |
| Less: unearned discount   | (3,401)      | (2,886)      |
| Less: allowance for loan losses   | (14,060)     | (12,615)     |
| Net loans   | 913,764      | 837,268      |
| FHLB and other equity interests   | 6,684        | 6,537        |
| Premises and equipment, net   | 24,072       | 24,004       |
| Bank owned life insurance   | 27,645       | 25,672       |
| Mortgage servicing rights   | 714          | 906          |
| Goodwill  | 10,946       | 10,821       |
| Accrued interest receivable and other assets  | 12,980       | 14,290       |
| Total Assets  | \$ 1,773,079 | \$ 1,602,207 |
| <b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>                                  |              |              |
| Non-interest bearing deposits   | \$ 175,239   | \$ 152,732   |
| Interest bearing deposits   | 1,309,764    | 1,201,119    |
| Total deposits  | 1,485,003    | 1,353,851    |
| FHLB and other borrowings   | 97,806       | 74,456       |
| Subordinated debentures   | 20,620       | 20,620       |
| Accrued interest payable and other liabilities                                      | 24,286       | 21,391       |
| Total liabilities   | 1,627,715    | 1,470,318    |
| Common stock, \$0 par value; authorized 50,000,000 shares; issued 12,599,603 shares | -            | -            |
| Additional paid in capital  | 44,223       | 44,350       |
| Retained earnings   | 88,960       | 80,038       |
| Treasury stock, at cost (123,699 shares for 2012 and 222,285 for 2011)              | (1,743)      | (3,260)      |
| Accumulated other comprehensive income  | 13,924       | 10,761       |
| Total shareholders' equity  | 145,364      | 131,889      |

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|   |              |              |
|---|--------------|--------------|
| Total Liabilities and Shareholders Equity | \$ 1,773,079 | \$ 1,602,207 |
|---|--------------|--------------|

See Notes to Consolidated Financial Statements

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## CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

Dollars in thousands, except per share data

|   | Year ended December 31, |               |                |
|---|-------------------------|---------------|----------------|
|   | 2012                    | 2011          | 2010           |
| <b>Interest and Dividend Income:</b>  |                         |               |                |
| Loans including fees  | \$ 49,760               | \$ 48,324     | \$ 46,955      |
| Deposits with banks   | 3                       | 110           | 125            |
| <b>Securities:</b>  |                         |               |                |
| Taxable   | 14,685                  | 14,285        | 11,603         |
| Tax-exempt  | 3,595                   | 2,957         | 2,435          |
| Dividends   | 86                      | 36            | 29             |
| <b>Total interest and dividend income</b>   | <b>68,129</b>           | <b>65,712</b> | <b>61,147</b>  |
| <b>Interest Expense:</b>  |                         |               |                |
| Deposits  | 10,875                  | 13,625        | 13,558         |
| Borrowed funds  | 3,245                   | 3,176         | 4,716          |
| Subordinated debentures   | 800                     | 778           | 782            |
| <b>Total interest expense</b>   | <b>14,920</b>           | <b>17,579</b> | <b>19,056</b>  |
| <b>Net Interest Income</b>  | <b>53,209</b>           | <b>48,133</b> | <b>42,091</b>  |
| <b>Provision for Loan Losses</b>  | <b>6,381</b>            | <b>4,937</b>  | <b>5,158</b>   |
| <b>Net Interest Income After Provision for Loan Losses</b>  | <b>46,828</b>           | <b>43,196</b> | <b>36,933</b>  |
| <b>Non-Interest Income:</b>   |                         |               |                |
| Wealth and asset management fees  | 1,819                   | 1,691         | 1,829          |
| Service charges on deposit accounts   | 4,106                   | 4,233         | 4,226          |
| Other service charges and fees  | 1,868                   | 1,626         | 1,396          |
| Net realized gains (losses) from sales of securities for which fair value was elected                   | 298                     | 30            | (68)           |
| Net unrealized gains on securities for which fair value was elected                                     | 266                     | 34            | 230            |
| Mortgage banking  | 990                     | 735           | 814            |
| Bank owned life insurance   | 973                     | 930           | 802            |
| Other   | 965                     | 1,224         | 1,002          |
|   | 11,285                  | 10,503        | 10,231         |
| <b>Total other-than-temporary impairment losses on available-for-sale securities</b>                    | <b>-</b>                | <b>(398)</b>  | <b>(2,241)</b> |
| Less portion of loss recognized in other comprehensive income   | -                       | -             | -              |
| <b>Net impairment losses recognized in earnings</b>   | <b>-</b>                | <b>(398)</b>  | <b>(2,241)</b> |
| Net realized gains on available-for-sale securities   | 1,379                   | 614           | 1,660          |
| <b>Net impairment losses recognized in earnings and realized gains on available-for-sale securities</b> | <b>1,379</b>            | <b>216</b>    | <b>(581)</b>   |
| <b>Total non-interest income</b>  | <b>12,664</b>           | <b>10,719</b> | <b>9,650</b>   |
| <b>Non-Interest Expenses:</b>   |                         |               |                |
| Salaries  | 13,106                  | 12,349        | 11,358         |
| Employee benefits   | 5,787                   | 4,936         | 4,328          |
| Net occupancy expense   | 4,651                   | 4,416         | 4,326          |

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|   |           |           |           |
|---|-----------|-----------|-----------|
| Data processing   | 2,791     | 2,754     | 2,797     |
| State and local taxes   | 1,474     | 1,275     | 1,162     |
| Legal, professional and examination fees  | 1,265     | 956       | 849       |
| Advertising   | 859       | 822       | 795       |
| FDIC insurance  | 1,115     | 1,259     | 1,619     |
| Directors fees and benefits   | 666       | 591       | 437       |
| Other   | 4,231     | 3,924     | 4,127     |
| <br>  |           |           |           |
| Total non-interest expenses   | 35,945    | 33,282    | 31,798    |
| <br>  |           |           |           |
| Income Before Income Taxes  | 23,547    | 20,633    | 14,785    |
| Income Tax Expense  | 6,411     | 5,529     | 3,469     |
| <br>  |           |           |           |
| Net Income  | 17,136    | 15,104    | 11,316    |
| <br>  |           |           |           |
| Other Comprehensive Income:   |           |           |           |
| Net change in unrealized gains/losses on available-for-sale securities, net of reclassification and tax | 3,561     | 14,441    | 2,554     |
| Change in actuarial gain, net of amortization and tax, for post-employment health care plan, net of tax | (349)     | (485)     | (245)     |
| Change in fair value of interest rate swap agreements designated as a cash flow hedge, net of tax       | (49)      | (522)     | (107)     |
| <br>  |           |           |           |
| Total other comprehensive income  | 3,163     | 13,434    | 2,202     |
| <br>  |           |           |           |
| Comprehensive Income  | \$ 20,299 | \$ 28,538 | \$ 13,518 |
| <br>  |           |           |           |
| Earnings Per Share:   |           |           |           |
| Basic   | \$ 1.38   | \$ 1.23   | \$ 1.06   |
| Diluted   | 1.38      | 1.23      | 1.06      |

See Notes to Consolidated Financial Statements

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## CONSOLIDATED STATEMENTS OF CASH FLOWS

Dollars in thousands

|  | Year ended December 31, |                  |                  |
|--|-------------------------|------------------|------------------|
|  | 2012                    | 2011             | 2010             |
| <b>Cash Flows From Operating Activities:</b>   |                         |                  |                  |
| Net income   | \$ 17,136               | \$ 15,104        | \$ 11,316        |
| Adjustments to reconcile net income to net cash provided by operations:                        |                         |                  |                  |
| Provision for loan losses  | 6,381                   | 4,937            | 5,158            |
| Depreciation and amortization of premises and equipment  | 2,225                   | 2,075            | 2,034            |
| Securities amortization and accretion and deferred loan fees and costs                         | 4,509                   | 2,786            | 1,466            |
| Deferred taxes   | (240)                   | 441              | 2,251            |
| Net impairment losses realized in earnings and gains on sales of available-for-sale securities | (1,379)                 | (216)            | 581              |
| Net realized and unrealized gains on securities for which fair value was elected               | (564)                   | (64)             | (162)            |
| Proceeds from sale of securities for which fair value was elected                              | 3,386                   | 343              | 34               |
| Purchase of securities for which fair value was elected  | (4,187)                 | (1,266)          | -                |
| Gain on sale of loans  | (927)                   | (638)            | (688)            |
| Net gains on dispositions of premises and equipment and foreclosed assets                      | (158)                   | (104)            | (117)            |
| Proceeds from sale of loans  | 32,512                  | 23,324           | 22,585           |
| Origination of loans held for sale   | (32,626)                | (19,927)         | (28,706)         |
| Income on bank owned life insurance  | (973)                   | (930)            | (802)            |
| Stock-based compensation expense   | 277                     | 213              | 205              |
| Contribution of treasury stock   | 120                     | 120              | 26               |
| Changes in:  |                         |                  |                  |
| Accrued interest receivable and other assets   | (455)                   | (1,342)          | (3,661)          |
| Accrued interest payable and other liabilities   | 2,523                   | 5,529            | (374)            |
| <b>Net Cash Provided By Operating Activities</b>   | <b>27,560</b>           | <b>30,385</b>    | <b>11,146</b>    |
| <b>Cash Flows from Investing Activities:</b>   |                         |                  |                  |
| Net (increase) decrease in interest bearing time deposits with other banks                     | (1)                     | 2,593            | 3,571            |
| Proceeds from maturities, prepayments and calls of securities                                  | 109,673                 | 101,178          | 111,827          |
| Proceeds from sales of securities  | 125,579                 | 69,740           | 95,381           |
| Purchase of securities   | (332,155)               | (288,757)        | (360,837)        |
| Loan origination and payments, net   | (82,393)                | (58,552)         | (80,435)         |
| Purchase of bank owned life insurance  | (1,000)                 | (5,000)          | (2,500)          |
| Acquisition of consumer discount company   | (1,248)                 | -                | -                |
| Redemption (purchase) of FHLB and other equity interests                                       | (147)                   | (122)            | 492              |
| Purchase of premises and equipment   | (2,016)                 | (1,705)          | (1,992)          |
| Proceeds from the sale of premises and equipment and foreclosed assets                         | 1,088                   | 257              | 823              |
| <b>Net Cash Used In Investing Activities</b>   | <b>(182,620)</b>        | <b>(180,368)</b> | <b>(233,670)</b> |
| <b>Cash Flows From Financing Activities:</b>   |                         |                  |                  |
| Net change in:   |                         |                  |                  |
| Checking, money market and savings accounts  | 186,262                 | 292,369          | 159,805          |
| Certificates of deposit  | (55,110)                | (101,386)        | 46,205           |
| Proceeds from sale of treasury stock   | 526                     | 1,188            | 1,200            |
| Proceeds from exercise of stock options  | 424                     | 259              | 69               |
| Proceeds from stock offering, net of issuance costs  | -                       | -                | 32,128           |
| Cash dividends paid  | (8,214)                 | (8,125)          | (6,933)          |
| Proceeds from long-term borrowings   | -                       | 700              | 20,000           |
| Repayments on long-term borrowings   | (160)                   | (133)            | (46,114)         |
| Net change in short-term borrowings  | 23,510                  | (32,618)         | 31,238           |
| <b>Net Cash Provided By Financing Activities</b>   | <b>147,238</b>          | <b>152,254</b>   | <b>237,598</b>   |

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|   |                  |                  |                  |
|---|------------------|------------------|------------------|
| Net (Decrease) Increase in Cash and Cash Equivalents        | (7,822)          | 2,271            | 15,074           |
| Cash and Cash Equivalents, Beginning                        | 39,703           | 37,432           | 22,358           |
| <b>Cash and Cash Equivalents, Ending</b>                    | <b>\$ 31,881</b> | <b>\$ 39,703</b> | <b>\$ 37,432</b> |
| Supplemental Disclosure of Cash Flow Information:           |                  |                  |                  |
| Cash paid during the period for:                            |                  |                  |                  |
| Interest  | \$ 15,205        | \$ 17,937        | \$ 19,296        |
| Income taxes  | 7,548            | 3,991            | 3,342            |
| Supplemental Noncash Disclosures:                           |                  |                  |                  |
| Transfers to other real estate owned                        | \$ 750           | \$ 249           | \$ 453           |
| Loans transferred from held for sale to held for investment | -                | -                | 3,321            |
| Grant of restricted stock awards from treasury stock        | 419              | 266              | 233              |

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## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2012, 2011, AND 2010

Dollars in thousands, except share and per share data

|  | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total<br>Share-<br>holders<br>Equity |
|--|----------------------------------|----------------------|-------------------|---|--------------------------------------|
| Balance, January 1, 2010   | \$ 12,631                        | \$ 68,676            | \$ (7,023)        | \$ (4,875)  | \$ 69,409                            |
| Net income   |                                  | 11,316               |                   |   | 11,316                               |
| Other comprehensive income                                       |                                  |                      |                   | 2,202   | 2,202                                |
| Common shares issued (3,365,853 shares)                          | 32,128                           |                      |                   |   | 32,128                               |
| Restricted stock award grants (16,500 shares)                    | (233)                            |                      | 233               |   |                                      |
| Forfeiture of restricted stock award grants (1,343 shares)       | 20                               |                      | (20)              |   |                                      |
| Exercise of stock options (8,206 shares), including tax benefit  | (37)                             |                      | 121               |   | 84                                   |
| Stock based compensation expense                                 | 205                              |                      |                   |   | 205                                  |
| Reissue of treasury stock (86,772 shares)                        | (38)                             |                      | 1,272             |   | 1,234                                |
| Cash dividends declared (\$0.66 per share)                       |                                  | (6,933)              |                   |   | (6,933)                              |
| Balance, December 31, 2010                                       | 44,676                           | 73,059               | (5,417)           | (2,673)   | 109,645                              |
| Net income   |                                  | 15,104               |                   |   | 15,104                               |
| Other comprehensive income                                       |                                  |                      |                   | 13,434  | 13,434                               |
| Restricted stock award grants (17,900 shares)                    | (266)                            |                      | 266               |   |                                      |
| Forfeiture of restricted stock award grants (1,488 shares)       | 22                               |                      | (22)              |   |                                      |
| Exercise of stock options (28,750 shares), including tax benefit | (133)                            |                      | 443               |   | 310                                  |
| Stock based compensation expense                                 | 213                              |                      |                   |   | 213                                  |
| Reissue of treasury stock (94,895 shares)                        | (162)                            |                      | 1,470             |   | 1,308                                |
| Cash dividends declared (\$0.66 per share)                       |                                  | (8,125)              |                   |   | (8,125)                              |
| Balance, December 31, 2011                                       | 44,350                           | 80,038               | (3,260)           | 10,761  | 131,889                              |
| Net income   |                                  | 17,136               |                   |   | 17,136                               |
| Other comprehensive income                                       |                                  |                      |                   | 3,163   | 3,163                                |
| Restricted stock award grants (26,900 shares)                    | (414)                            |                      | 414               |   |                                      |
| Exercise of stock options (31,875 shares), including tax benefit | (27)                             |                      | 491               |   | 464                                  |
| Stock based compensation expense                                 | 277                              |                      |                   |   | 277                                  |
| Reissue of treasury stock (39,811 shares)                        | 37                               |                      | 612               |   | 649                                  |
| Cash dividends declared (\$0.66 per share)                       |                                  | (8,214)              |                   |   | (8,214)                              |
| Balance, December 31, 2012                                       | \$ 44,223                        | \$ 88,960            | \$ (1,743)        | \$ 13,924   | \$ 145,364                           |

See Notes to Consolidated Financial Statements





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**Notes to Consolidated Financial Statements**

(Dollars in thousands, except per share data)

**1. Summary of Significant Accounting Policies**

Unless otherwise indicated, dollar amounts are in thousands, except per share data.

**Business and Organization**

CNB Financial Corporation (the Corporation) is headquartered in Clearfield, Pennsylvania, and provides a full range of banking and related services through its wholly owned subsidiary, CNB Bank (the Bank). In addition, the Bank provides trust and asset management services, including the administration of trusts and estates, retirement plans, and other employee benefit plans as well as a full range of wealth management services. The Bank serves individual and corporate customers and is subject to competition from other financial institutions and intermediaries with respect to these services. In addition to the Bank, the Corporation also operates a consumer discount loan and finance business through its wholly owned subsidiary, Holiday Financial Services Corporation (Holiday). The Corporation and these and its other subsidiaries are subject to examination by federal and state regulators. The Corporation's market area is primarily concentrated in the central and northwest regions of the Commonwealth of Pennsylvania.

**Basis of Financial Presentation**

The financial statements are consolidated to include the accounts of the Corporation and the Bank, CNB Securities Corporation, Holiday, County Reinsurance Company, and CNB Insurance Agency. All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements.

**Use of Estimates**

To prepare financial statements in conformity with accounting principles generally accepted in the U.S., management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ. The allowance for loan losses, carrying value of goodwill, mortgage servicing rights, and fair values of financial instruments are particularly subject to change.

**Operating Segments**

While the chief decision-makers monitor the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Corporation-wide basis. Operating segments are aggregated into one as operating results for all segments are similar and the accounts of County Reinsurance Company and CNB Insurance Agency are not material to the consolidated financial statements. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable operating segment.

**Interest Bearing Time Deposits with Other Banks**

Interest-bearing deposits in other financial institutions mature within one year and are carried at cost.

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### **Securities**

When purchased, securities are classified as held to maturity, trading or available for sale. Debt securities are classified as held to maturity when the Corporation has the positive intent and ability to hold the securities to maturity. Held to maturity securities are carried at amortized cost. Debt or equity securities are classified as trading when purchased principally for the purpose of selling them in the near term, or when the fair value option has been elected. Trading securities are recorded at fair value with changes in fair value included in earnings in non-interest income. Available for sale securities are those securities not classified as held to maturity or trading and are carried at their fair value. Unrealized gains and losses, net of deferred tax, on securities classified as available for sale are recorded as other comprehensive income. Management has not classified any debt securities as held to maturity.

The amortized cost of debt securities classified as held to maturity or available for sale is adjusted for the amortization of premiums and the accretion of discounts over the period through contractual maturity or, in the case of mortgage-backed securities and collateralized mortgage obligations, over the estimated life of the security. Such amortization is included in interest income from securities. Gains and losses on securities sold are recorded on the trade date and based on the specific identification method.

Declines in the fair value of debt securities below their cost that are other than temporary and attributable to credit losses are reflected in earnings. Other-than-temporary impairment losses that are not attributable to credit losses are reported as a component of accumulated other comprehensive income. In estimating other-than-temporary losses, management considers: the length of time and extent that fair value has been less than cost, the financial condition and near term prospects of the issuer, and the Corporation's intent to sell, or whether it is more likely than not that it will be required to sell a security in an unrealized loss position before recovery of its amortized cost basis. If the Corporation intends to sell a security or it is more likely than not it will be required to sell a security before recovery of its amortized cost basis, the entire difference between amortized cost and fair value is recognized as impairment through earnings.

### **Loans**

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding.

Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term. Interest income on commercial, industrial, and agricultural loans, commercial mortgage loans, and residential real estate loans is discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection. Consumer loans are typically charged off no later than 180 days past due. Past due status is based on the contractual terms of the loan. Loans, including loans modified in a troubled debt restructuring, are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. For all portfolio segments, loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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### **Concentration of Credit Risk**

Most of the Corporation's business activity is with customers located within the Commonwealth of Pennsylvania. Therefore, the Corporation's exposure to credit risk is significantly affected by changes in Pennsylvania's economy.

### **Loans Held for Sale**

Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

Mortgage loans held for sale are generally sold with servicing rights retained. The carrying value of the mortgage loan sold is reduced by the amount allocated to the servicing right. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

### **Allowance for Loan Losses**

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance account.

Management determines the adequacy of the allowance based on historical patterns of charge-offs and recoveries, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, industry experience, economic conditions, and other qualitative factors relevant to the collectability of the loan portfolio. While management believes that the allowance is adequate to absorb probable loan losses incurred at the balance sheet date, future adjustments may be necessary due to circumstances that differ substantially from the assumptions used in evaluating the adequacy of the allowance for loan losses.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful. A loan is impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

Commercial and commercial real estate loans are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures. Troubled debt restructurings are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Corporation determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

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The general component of the allowance for loan losses covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Corporation over the most recent 2 years. This actual loss experience is supplemented with other factors based on the risks present for each portfolio segment. These historical loss factors include consideration of the following: levels of and trends in delinquencies, non-accrual loans, and classified loans; trends in volume and terms of loans; effects of any changes in lending policies and procedures; experience, ability, and depth of management; national and local economic trends and conditions; and concentrations of credit.

The following portfolio segments, which are the same as the Corporation's portfolio classifications, and associated risk characteristics have been identified:

Commercial, industrial, and agricultural risk characteristics include recession-like economic conditions in many of the markets served by the Corporation and high levels of unemployment, which has caused consumer spending to slow.

Commercial mortgages the most significant risk characteristic is the subjectivity involved in real estate valuations for properties located in areas with stagnant or low growth economies.

Residential real estate risk characteristics include higher than historical levels of delinquencies and a weakened housing market.

Consumer risk characteristics include continuing weakness in industrial employment in many of the markets served by the Corporation and inflation.

Credit cards the most significant risk characteristic is the unsecured nature of credit card loans.

Overdrafts risk characteristics include the Corporation's continued deposit growth and overall economic conditions which may lead to a greater likelihood of overdrawn deposit accounts.

### **Federal Home Loan Bank (FHLB) Stock**

As a member of the Federal Home Loan Bank of Pittsburgh ( FHLB ), the Corporation is required to purchase and hold stock in the FHLB to satisfy membership and borrowing requirements. This stock is restricted in that it can only be sold to the FHLB or to another member institution, and all sales of FHLB stock must be at par. As a result of these restrictions, FHLB stock is unlike other investment securities insofar as there is no trading market for FHLB stock and the transfer price is determined by FHLB membership rules and not by market participants.

FHLB stock is held as a long-term investment, is valued at its cost basis and is analyzed for impairment based on the ultimate recoverability of the par value. The Company evaluates impairment quarterly. The decision of whether impairment exists is a matter of judgment that reflects our view of the FHLB's long-term performance, which includes factors such as the following:

its operating performance;

the severity and duration of declines in the fair value of its net assets related to its capital stock amount;

its commitment to make payments required by law or regulation and the level of such payments in relation to its operating performance;

the impact of legislative and regulatory changes on the FHLB, and accordingly, on the members of FHLB; and

its liquidity and funding position.

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### **Premises and Equipment**

Premises and equipment are stated at cost less accumulated depreciation. Depreciation of premises and equipment is computed principally by the straight line method. In general, useful lives range from 3 to 39 years with lives for furniture, fixtures and equipment ranging from 3 to 10 years and lives of buildings and building improvements ranging from 15 to 39 years. Amortization of leasehold improvements is computed using the straight-line method over useful lives of the leasehold improvements or the term of the lease, whichever is shorter. Maintenance, repairs and minor renewals are charged to expense as incurred.

### **Foreclosed Assets**

Assets acquired through or in lieu of loan foreclosure are initially recorded at fair value less estimated selling costs when acquired, establishing a new cost basis, and are then carried at the lower of cost or fair value. If fair value declines, a valuation allowance is recorded through expense. Costs after acquisition are expensed.

### **Bank Owned Life Insurance**

The Corporation has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

### **Goodwill and Other Intangible Assets**

Goodwill resulting from business combinations prior to January 1, 2009 represents the excess of the purchase price over the fair value of the net assets of businesses acquired. Goodwill resulting from business combinations after January 1, 2009 represents the future economic benefits arising from other assets acquired that are not individually identified and separately recognized. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. The Corporation has selected December 31 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives. Goodwill is the only intangible asset with an indefinite life on the Corporation's balance sheet.

### **Long-term Assets**

Premises and equipment, goodwill and other intangible assets, and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

### **Loan Commitments and Related Financial Instruments**

Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

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**Derivatives**

Derivative financial instruments are recognized as assets or liabilities at fair value. The Corporation has interest rate swap agreements which are used as part of its asset liability management to help manage interest rate risk. The Corporation does not use derivatives for trading purposes.

At the inception of a derivative contract, the Corporation designates the derivative as one of three types based on the purpose of the contract and belief as to its effectiveness as a hedge. These three types are (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ( fair value hedge ), (2) a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ( cash flow hedge ), or (3) an instrument with no hedging designation ( stand-alone derivative ). For a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item, are recognized in current earnings as fair values change. For a cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. For both types of hedges, changes in the fair value of derivatives that are not highly effective in hedging the changes in fair value or expected cash flows of the hedged item are recognized immediately in current earnings. Changes in the fair value of derivatives that do not qualify for hedge accounting are reported currently in earnings, as noninterest income.

Net cash settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged. Net cash settlements on derivatives that do not qualify for hedge accounting are reported in noninterest income. Cash flows on hedges are classified in the cash flow statement the same as the cash flows of the items being hedged.

The Corporation formally documents the relationship between derivatives and hedged items, as well as the risk-management objective and the strategy for undertaking hedge transactions, at the inception of the hedging relationship. This documentation includes linking fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Corporation also formally assesses, both at the hedge s inception and on an ongoing basis, whether the derivative instruments that are used are highly effective in offsetting changes in fair values or cash flows of the hedged items. The Corporation discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative is settled or terminates, a hedged forecasted transaction is no longer probable, a hedged firm commitment is no longer firm, or treatment of the derivative as a hedge is no longer appropriate or intended.

When hedge accounting is discontinued, subsequent changes in fair value of the derivative are recorded as noninterest income. When a fair value hedge is discontinued, the hedged asset or liability is no longer adjusted for changes in fair value and the existing basis adjustment is amortized or accreted over the remaining life of the asset or liability. When a cash flow hedge is discontinued but the hedged cash flows or forecasted transactions are still expected to occur, gains or losses that were accumulated in other comprehensive income are amortized into earnings over the same periods which the hedged transactions will affect earnings.

**Advertising Costs**

Advertising costs are generally expensed as incurred and amounted to \$859, \$822, and \$795, for 2012, 2011 and 2010 respectively.

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### **Mortgage Servicing Rights**

Servicing rights are recognized separately when they are acquired through sales of loans. Servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. The Corporation compares the valuation model inputs and results to published industry data in order to validate the model results and assumptions. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing rights are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Corporation later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income. Changes in valuation allowances are reported with mortgage banking income on the income statement. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Servicing fee income, which is reported on the income statement as mortgage banking income, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal or a fixed amount per loan and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income. Late fees and ancillary fees related to loan servicing are not material.

### **Common Stock Issuance**

On June 18, 2010, the Corporation completed an equity offering, resulting in the issuance of 3,365,853 shares of common stock at \$10.25 per share. In total, the Corporation raised proceeds of \$32,128, net of issuance costs.

### **Treasury Stock**

The purchase of the Corporation's common stock is recorded at cost. Purchases of the stock are made both in the open market and through negotiated private purchases based on market prices. At the date of subsequent reissue, the treasury stock account is reduced by the cost of such stock on a first-in-first-out basis.

### **Stock-Based Compensation**

The Corporation has a stock incentive plan for key employees and independent directors. The Stock Incentive Plan, which is administered by a committee of the Board of Directors, provides for up to 500,000 shares of common stock in the form of nonqualified options or restricted stock. For key

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employees, the plan vesting schedule is one-fourth of granted stock-based awards per year beginning one year after the grant date with 100% vested on the fourth anniversary. For independent directors, the vesting schedule is one-third of granted stock-based awards per year beginning one year after the grant date with 100% vested on the third anniversary.

At December 31, 2012 and 2011, there was no unrecognized compensation cost related to nonvested stock options granted under this plan, and no stock options were granted during the years then ended.

During 2012, 2011 and 2010, the Executive Compensation and Personnel Committee of the Board of Directors granted a total of 26,900, 17,900 and 16,500 shares, respectively, of restricted common stock to certain key employees and all independent directors of the Corporation. Compensation expense for the restricted stock awards is recognized over the requisite service period based on the fair value of the shares at the date of grant on a straight-line basis. Unearned restricted stock awards are recorded as a reduction of shareholders' equity until earned. Compensation expense resulting from these restricted stock awards was \$277, \$213 and \$205 for the years ended December 31, 2012, 2011 and 2010, respectively.

## **Comprehensive Income**

The Corporation presents comprehensive income as part of the Consolidated Statement of Income and Comprehensive Income. Other comprehensive income (loss) consists of unrealized holding gains (losses) on the available for sale securities portfolio, changes in the unrecognized actuarial gain and transition obligation related to the Corporation's post retirement benefits plan, and changes in the fair value of the Corporation's interest rate swaps.

## **Income Taxes**

The Corporation files a consolidated U.S. income tax return that includes all subsidiaries except County Reinsurance Company which files a separate return. Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the more likely than not test, no tax benefit is recorded.

The Corporation recognizes interest and/or penalties related to income tax matters in income tax expense.

## **Retirement Plans**

The Corporation's expense associated with its 401(k) plan is determined under the provisions of the plan document and includes both matching and profit sharing components. Deferred compensation and supplemental retirement plan expenses allocate the benefits over years of service.

## **Earnings Per Share**

Basic earnings per share is computed by dividing net income available to common shareholders by the weighted average number of shares outstanding during the applicable period, excluding outstanding



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participating securities. Diluted earnings per share is computed using the weighted average number of shares determined for the basic computation plus the dilutive effect of potential common shares issuable under certain stock compensation plans. Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are included in the computation of earnings per share pursuant to the two-class method. The Corporation has determined that its outstanding non-vested stock awards are participating securities.

## **Cash and Cash Equivalents**

For purposes of the consolidated statement of cash flows, the Corporation defines cash and cash equivalents as cash and due from banks, interest bearing deposits with other banks, and Federal funds sold. Net cash flows are reported for customer loan and deposit transactions, interest bearing time deposits with other banks and borrowings with original maturities of 90 days or less.

## **Restrictions on Cash**

The Bank is required to maintain average reserve balances with the Federal Reserve Bank or in vault cash. The average amount of these non-interest bearing reserve balances for the year ended December 31, 2012 and 2011, was \$50, which was maintained in vault cash. Note 11 to the consolidated financial statements discloses the cash collateral balances required to be maintained in connection with the Corporation's interest rate swaps.

## **Loss Contingencies**

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are any such matters that will have a material effect on the financial statements.

## **Fair Value of Financial Instruments**

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

## **Adoption of New Accounting Standards**

In May 2011, the FASB issued Accounting Standards Update No. 2011-4, Fair Value Measurement (Topic 820), Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. Some amendments in this update clarify the FASB's intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The amendments in this update are effective during interim and annual reporting periods beginning after December 15, 2011. The Corporation complied with the revised disclosure requirements.

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In June 2011, the FASB issued Accounting Standards Update No. 2011-5, *Comprehensive Income (Topic 220), Presentation of Comprehensive Income*. This update amends the FASB Accounting Standards Codification (Codification) to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This update eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments to the Codification in this update do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The amendments in this update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, and retrospective application is required. The Corporation complied with the revised disclosure requirements.

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, *Intangibles—Goodwill and Other (Topic 350), Testing Goodwill for Impairment*. The amendments in the update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The more-likely-than-not threshold is defined as having a likelihood of more than fifty percent. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The effect of adopting this new guidance did not have a material effect on the Corporation's financial statements.

In December 2011, the FASB issued Accounting Standards Update No. 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 (ASU 2011-12)*. This ASU defers only those changes in ASU 2011-05 that relate to the presentation of reclassification adjustments. Entities are to continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU 2011-05. The other requirements in ASU 2011-05 were not affected by this ASU. Further guidance surrounding the reclassification of items out of accumulated other comprehensive income was provided by FASB in ASU 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*.

In February 2013, FASB issued Accounting Standards Update 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (ASU 2013-02)*. The ASU requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about these amounts. The new guidance is effective prospectively for reporting periods beginning after December 15, 2012. The Corporation is evaluating the effect that the adoption of ASU 2013-02 will have on its financial statements.

## **Reclassifications**

Certain prior year amounts have been reclassified for comparative purposes.

**Table of Contents****2. Earnings Per Share**

The computation of basic and diluted earnings per share is shown below (in thousands, except per share data). For the years ended December 31, 2012, 2011, and 2010, options to purchase 37,500, 75,500, and 84,250 shares of common stock were not considered in computing diluted earnings per share because they were anti-dilutive.

|  | Years Ended December 31 |           |           |
|--|-------------------------|-----------|-----------|
|  | 2012                    | 2011      | 2010      |
| <b>Basic earnings per common share computation</b>   |                         |           |           |
| Net income per consolidated statements of income   | \$ 17,136               | \$ 15,104 | \$ 11,316 |
| Net earnings allocated to participating securities   | (62)                    | (42)      | (33)      |
| Net earnings allocated to common stock   | \$ 17,074               | \$ 15,062 | \$ 11,283 |
| Distributed earnings allocated to common stock   | \$ 8,182                | \$ 8,101  | \$ 6,914  |
| Undistributed earnings allocated to common stock   | 8,892                   | 6,961     | 4,369     |
| Net earnings allocated to common stock   | \$ 17,074               | \$ 15,062 | \$ 11,283 |
| Weighted average common shares outstanding, including shares considered participating securities | 12,441                  | 12,306    | 10,630    |
| Less: Average participating securities   | (41)                    | (33)      | (30)      |
| Weighted average shares  | 12,400                  | 12,273    | 10,600    |
| Basic earnings per common share  | \$ 1.38                 | \$ 1.23   | \$ 1.06   |
| <b>Diluted earnings per common share computation</b>   |                         |           |           |
| Net earnings allocated to common stock   | \$ 17,074               | \$ 15,062 | \$ 11,283 |
| Weighted average common shares outstanding for basic earnings per common share                   | 12,400                  | 12,273    | 10,600    |
| Add: Dilutive effects of assumed exercises of stock options                                      | 3                       | 6         | 9         |
| Weighted average shares and dilutive potential common shares                                     | 12,403                  | 12,279    | 10,609    |
| Diluted earnings per common share  | \$ 1.38                 | \$ 1.23   | \$ 1.06   |

**3. Securities**

Securities available-for-sale at December 31, 2012 and 2011 are as follows:

|                                     | December 31, 2012 |                     |                      |               | December 31, 2011 |                     |                      |               |
|-------------------------------------|-------------------|---------------------|----------------------|---------------|-------------------|---------------------|----------------------|---------------|
|                                     | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value |
| U.S. Treasury                       | \$ 4,018          | \$ 18               | \$ -                 | \$ 4,036      | \$ 8,064          | \$66                | \$ -                 | \$ 8,130      |
| U.S. Gov t sponsored entities       | 157,965           | 5,977               | (161)                | 163,781       | 102,258           | 5,249               | (15)                 | 107,492       |
| State & political subdivisions      | 170,223           | 11,113              | (57)                 | 181,279       | 149,685           | 8,844               | (92)                 | 158,437       |
| Residential & multi-family mortgage | 308,800           | 8,724               | (702)                | 316,822       | 292,297           | 8,043               | (214)                | 300,126       |
| Commercial mortgage                 | 1,275             | 29                  | -                    | 1,304         | 2,077             | 45                  | -                    | 2,122         |

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|                         |                  |                 |                  |                  |                  |                 |                  |                  |
|-------------------------|------------------|-----------------|------------------|------------------|------------------|-----------------|------------------|------------------|
| Corporate notes & bonds | 17,368           | 26              | (2,370)          | 15,024           | 17,358           | 50              | (3,548)          | 13,860           |
| Pooled trust preferred  | 800              | -               | (200)            | 600              | 800              | -               | (460)            | 340              |
| Pooled SBA              | 50,667           | 2,277           | (17)             | 52,927           | 44,851           | 1,282           | (77)             | 46,056           |
| Other securities        | 1,521            | 17              | -                | 1,538            | 1,521            | 23              | -                | 1,544            |
| <b>Total</b>            | <b>\$712,637</b> | <b>\$28,181</b> | <b>\$(3,507)</b> | <b>\$737,311</b> | <b>\$618,911</b> | <b>\$23,602</b> | <b>\$(4,406)</b> | <b>\$638,107</b> |

At December 31, 2012 and 2011, there were no holdings of securities by any one issuer, other than U.S. Government sponsored entities, in an amount greater than 10% of shareholders' equity.

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Trading securities accounted for under the fair value option at December 31, 2012 and 2011 are as follows:

|   | 2012     | 2011     |
|---|----------|----------|
| Corporate equity securities               | \$ 3,117 | \$ 1,959 |
| Certificates of deposit                   | 408      | 255      |
| International mutual funds                | 287      | 257      |
| Large cap growth mutual funds             | 157      | 145      |
| Money market mutual funds                 | 110      | 241      |
| Large cap value mutual funds              | 104      | 105      |
| Corporate notes and bonds                 | 101      | 100      |
| Real estate investment trust mutual funds | 65       | 68       |
| U.S. Government sponsored entities        | 58       | 55       |
| Small cap mutual funds                    | 26       | 25       |
| Mid cap mutual funds                      | 26       | 23       |
| Total                                     | \$ 4,459 | \$ 3,233 |

Securities with unrealized losses at December 31, 2012 and 2011, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

| Description of Securities           | December 31, 2012 |                 | Less than 12 Months |                 | 12 Months or More |                 | Total      |                 |
|-------------------------------------|-------------------|-----------------|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
|                                     | Fair Value        | Unrealized Loss | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. Treasury                       | \$ -              | \$ -            | \$ -                | \$ -            | \$ -              | \$ -            | \$ -       | \$ -            |
| U.S. Gov t sponsored entities       | 41,715            | (161)           | -                   | -               | -                 | -               | 41,715     | (161)           |
| State & political subdivisions      | 7,857             | (57)            | -                   | -               | -                 | -               | 7,857      | (57)            |
| Residential & multi-family mortgage | 32,159            | (688)           | 4,254               | (14)            | 36,413            | (702)           |            |                 |
| Commercial mortgage                 | -                 | -               | -                   | -               | -                 | -               | -          | -               |
| Corporate notes & bonds             | -                 | -               | 13,002              | (2,370)         | 13,002            | (2,370)         |            |                 |
| Pooled trust preferred              | -                 | -               | 600                 | (200)           | 600               | (200)           |            |                 |
| Pooled SBA                          | 3,521             | (17)            | -                   | -               | 3,521             | (17)            |            |                 |
| Other securities                    | -                 | -               | -                   | -               | -                 | -               | -          | -               |
|                                     | \$ 85,252         | \$ (923)        | \$ 17,856           | \$ (2,584)      | \$ 103,108        | \$ (3,507)      |            |                 |

| Description of Securities             | December 31, 2011 |                 | Less than 12 Months |                 | 12 Months or More |                 | Total      |                 |
|---------------------------------------|-------------------|-----------------|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
|                                       | Fair Value        | Unrealized Loss | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. Treasury                         | \$ -              | \$ -            | \$ -                | \$ -            | \$ -              | \$ -            | \$ -       | \$ -            |
| U.S. Gov t sponsored entities         | 7,671             | (15)            | -                   | -               | -                 | -               | 7,671      | (15)            |
| State & political subdivisions        | 5,314             | (92)            | -                   | -               | -                 | -               | 5,314      | (92)            |
| Residential and multi-family mortgage | 36,626            | (162)           | 9,485               | (52)            | 46,111            | (214)           |            |                 |
| Commercial mortgage                   | -                 | -               | -                   | -               | -                 | -               | -          | -               |
| Corporate notes & bonds               | 2,860             | (139)           | 8,841               | (3,409)         | 11,701            | (3,548)         |            |                 |
| Pooled trust preferred                | -                 | -               | 340                 | (460)           | 340               | (460)           |            |                 |
| Pooled SBA                            | 8,139             | (77)            | -                   | -               | 8,139             | (77)            |            |                 |

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Other securities

|           |          |           |            |           |            |   |
|-----------|----------|-----------|------------|-----------|------------|---|
| -         | -        | -         | -          | -         | -          | - |
| \$ 60,610 | \$ (485) | \$ 18,666 | \$ (3,921) | \$ 79,276 | \$ (4,406) |   |

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The Corporation evaluates securities for other-than-temporary impairment on a quarterly basis, or more frequently when economic or market conditions warrant such an evaluation.

The following table provides detailed information related to the Corporation's structured pooled trust preferred securities as of December 31, 2012 and for the years ended December 31, 2012, 2011, and 2010:

|                                     | As of December 31, 2012 |                           |               | Credit Losses Realized<br>in Earnings |               |                 |
|-------------------------------------|-------------------------|---------------------------|---------------|---------------------------------------|---------------|-----------------|
|                                     | Adjusted                |                           |               | Year Ended December 31,               |               |                 |
|                                     | Amortized<br>Cost       | Unrealized<br>Gain (Loss) | Fair<br>Value | 2012                                  | 2011          | 2010            |
| ALESCO Preferred Funding V, Ltd.    | \$ 800                  | \$ (200)                  | \$ 600        | \$ -                                  | \$ -          | \$ 440          |
| ALESCO Preferred Funding XII, Ltd.  | -                       | -                         | -             | -                                     | 280           | 933             |
| ALESCO Preferred Funding XVII, Ltd. | -                       | -                         | -             | -                                     | -             | -               |
| Preferred Term Securities XVI, Ltd. | -                       | -                         | -             | -                                     | 118           | 868             |
| US Capital Funding VI, Ltd.         | -                       | -                         | -             | -                                     | -             | -               |
| <b>Total</b>                        | <b>\$ 800</b>           | <b>\$ (200)</b>           | <b>\$ 600</b> | <b>\$ -</b>                           | <b>\$ 398</b> | <b>\$ 2,241</b> |

At December 31, 2012, the Corporation evaluated the ALESCO Preferred Funding V, Ltd. Security for other than-temporary impairment by estimating the cash flows expected to be received, taking into account future estimated levels of deferrals and defaults by the underlying issuers and discounting those cash flows at the appropriate accounting yield.

A roll-forward of the other-than-temporary impairment amount related to credit losses for the years ended December 31, 2012, 2011 and 2010 is as follows:

|   | 2012            | 2011            | 2010            |
|---|-----------------|-----------------|-----------------|
| Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in other comprehensive income, beginning of period  | \$ 4,054        | \$ 3,656        | \$ 1,415        |
| Additional credit loss for which other-than-temporary impairment was not previously recognized  | -               | -               | 868             |
| Additional credit loss for which other-than-temporary impairment was previously recognized  | -               | 398             | 1,373           |
| <b>Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in other comprehensive income, end of period</b> | <b>\$ 4,054</b> | <b>\$ 4,054</b> | <b>\$ 3,656</b> |

Due to the insignificance of the adjusted amortized cost of structured pooled trust preferred securities as of December 31, 2012 and 2011, no further disclosures are required.

For the securities that comprise corporate notes and bonds and the securities that comprise states and political subdivisions, management monitors publicly available financial information such as filings with the Securities and Exchange Commission in order to evaluate the securities for other-than-temporary impairment. For financial institution issuers, management also monitors information from quarterly call report filings that are used to generate Uniform Bank Performance Reports. When

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reviewing this information, management considers the financial condition and near term prospects of the issuer and whether downgrades by bond rating agencies have occurred. Management also considers the length of time and extent to which fair value has been less than cost and the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

As of December 31, 2012 and 2011, management concluded that the securities described in the previous paragraph were not other-than-temporarily impaired for the following reasons:

There is no indication of any significant deterioration of the creditworthiness of the institutions that issued the securities. All contractual interest payments on the securities have been received as scheduled, and no information has come to management's attention through the processes previously described which would lead to a conclusion that future contractual payments will not be received timely.

The Corporation does not intend to sell and it is not more likely than not that it will be required to sell the securities in an unrealized loss position before recovery of its amortized cost basis.

On December 31, 2012 and 2011, securities carried at \$264,813 and \$264,166, respectively, were pledged to secure public deposits and for other purposes as provided by law.

The following is a schedule of the contractual maturity of securities available for sale, excluding equity securities, at December 31, 2012:

|                                       | December 31, 2012 |                   |
|---------------------------------------|-------------------|-------------------|
|                                       | Amortized Cost    | Fair Value        |
| 1 year or less                        | \$ 26,495         | \$ 26,741         |
| 1 year 5 years                        | 102,828           | 106,190           |
| 5 years 10 years                      | 167,676           | 177,533           |
| After 10 years                        | 53,375            | 54,256            |
|                                       | 350,374           | 364,720           |
| Residential and multi-family mortgage | 308,800           | 316,822           |
| Pooled SBA                            | 50,667            | 52,927            |
| Commercial mortgage                   | 1,275             | 1,304             |
| <b>Total debt securities</b>          | <b>\$ 711,116</b> | <b>\$ 735,773</b> |

Mortgage securities and pooled SBA securities are not due at a single date; periodic payments are received based on the payment patterns of the underlying collateral.

Information pertaining to security sales is as follows:

| Year ended December 31 | Proceeds   | Gross Gains | Gross Losses |
|------------------------|------------|-------------|--------------|
| 2012                   | \$ 125,579 | \$ 1,809    | \$ 430       |
| 2011                   | 69,740     | 878         | 264          |
| 2010                   | 95,381     | 1,677       | 17           |

The tax provision related to these net realized gains was \$483, \$215, and \$581, respectively.





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During 2012, 2011 and 2010, the Corporation sold securities carried at fair value under the fair value option. Proceeds were \$3,386 in 2012, \$343 in 2011 and \$34 in 2010, resulting in net gains (losses) of \$298 in 2012, \$30 in 2011, and (\$68) in 2010.

**4. Loans**

Total net loans at December 31, 2012 and 2011 are summarized as follows:

|  | 2012              | 2011              |
|--|-------------------|-------------------|
| Commercial, industrial, and agricultural | \$ 257,091        | \$ 253,324        |
| Commercial mortgages                     | 261,791           | 242,511           |
| Residential real estate                  | 347,904           | 298,628           |
| Consumer                                 | 58,668            | 53,471            |
| Credit cards                             | 4,800             | 4,412             |
| Overdrafts                               | 971               | 423               |
| Less: unearned discount                  | (3,401)           | (2,886)           |
| allowance for loan losses                | (14,060)          | (12,615)          |
| <b>Loans, net</b>                        | <b>\$ 913,764</b> | <b>\$ 837,268</b> |

At December 31, 2012 net unamortized loan costs of \$232 have been included in the carrying value of loans. As of December 31, 2011, net unamortized loan fees of \$7 have been included in the carrying value of loans.

The Corporation's outstanding loans and related unfunded commitments are primarily concentrated within Central and Western Pennsylvania. The Bank attempts to limit concentrations within specific industries by utilizing dollar limitations to single industries or customers, and by entering into participation agreements with third parties. Collateral requirements are established based on management's assessment of the customer.

Transactions in the allowance for loan losses for the year ended December 31, 2012 were as follows:

|   | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total     |
|---|--|-------------------------|-------------------------------|----------|-----------------|------------|-----------|
| Allowance for loan losses,<br>January 1, 2012   | \$ 4,511                                       | \$ 4,470                | \$ 1,991                      | \$ 1,404 | \$ 71           | \$ 168     | \$ 12,615 |
| Charge-offs                                     | (2,871)  | (401)                   | (304)                         | (1,279)  | (78)            | (257)      | (5,190)   |
| Recoveries                                      | 45   | -                       | 1                             | 91       | 18              | 99         | 254       |
| Provision for loan losses                       | 3,255  | 628                     | 778                           | 1,483    | 72              | 165        | 6,381     |
| Allowance for loan losses,<br>December 31, 2012 | \$ 4,940                                       | \$ 4,697                | \$ 2,466                      | \$ 1,699 | \$ 83           | \$ 175     | \$ 14,060 |

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Transactions in the allowance for loan losses for the year ended December 31, 2011 were as follows:

|   | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total     |
|---|--|-------------------------|-------------------------------|----------|-----------------|------------|-----------|
| Allowance for loan losses, January 1, 2011      | \$ 3,517                                       | \$ 3,511                | \$ 1,916                      | \$ 1,561 | \$ 96           | \$ 219     | \$ 10,820 |
| Charge-offs                                     | (1,796)  | (175)                   | (217)                         | (907)    | (39)            | (222)      | (3,356)   |
| Recoveries                                      | 9  | -                       | 13                            | 88       | 10              | 94         | 214       |
| Provision for loan losses                       | 2,781  | 1,134                   | 279                           | 662      | 4               | 77         | 4,937     |
| Allowance for loan losses,<br>December 31, 2011 | \$ 4,511                                       | \$ 4,470                | \$ 1,991                      | \$ 1,404 | \$ 71           | \$ 168     | \$ 12,615 |

Transactions in the allowance for loan losses for the year ended December 31, 2010 were as follows:

|                            |           |
|----------------------------|-----------|
| Balance, beginning of year | \$ 9,795  |
| Charge-offs                | (4,371)   |
| Recoveries                 | 238       |
| Net charge-offs            | (4,133)   |
| Provision for loan losses  | 5,158     |
| Balance, end of year       | \$ 10,820 |

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The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and is based on the Corporation's impairment method as of December 31, 2012 and 2011:

| <b>December 31, 2012</b>                        | <b>Commercial,<br/>Industrial, and<br/>Agricultural</b> | <b>Commercial<br/>Mortgages</b> | <b>Residential<br/>Real<br/>Estate</b> | <b>Consumer</b>  | <b>Credit<br/>Cards</b> | <b>Overdrafts</b> | <b>Total</b>      |
|---|---|---------------------------------|--|------------------|-------------------------|-------------------|-------------------|
| <b>Allowance for loan losses:</b>               |   |                                 |  |                  |                         |                   |                   |
| Ending allowance balance attributable to loans: |   |                                 |  |                  |                         |                   |                   |
| Individually evaluated for impairment           | \$ 541  | \$ 131                          | \$ 81                                  | \$ -             | \$ -                    | \$ -              | \$ 753            |
| Collectively evaluated for impairment           | 4,399   | 3,467                           | 2,385                                  | 1,699            | 83                      | 175               | 12,208            |
| Modified in a troubled debt restructuring       | -   | 1,099                           | -                                      | -                | -                       | -                 | 1,099             |
| <b>Total ending allowance balance</b>           | <b>\$ 4,940</b>   | <b>\$ 4,697</b>                 | <b>\$ 2,466</b>                        | <b>\$ 1,699</b>  | <b>\$ 83</b>            | <b>\$ 175</b>     | <b>\$ 14,060</b>  |
| <b>Loans:</b>                                   |   |                                 |  |                  |                         |                   |                   |
| Loans individually evaluated for impairment     | \$ 2,623  | \$ 10,683                       | \$ 593                                 | \$ -             | \$ -                    | \$ -              | \$ 13,899         |
| Loans collectively evaluated for impairment     | 253,048   | 240,907                         | 347,311                                | 58,668           | 4,800                   | 971               | 905,705           |
| Loans modified in a troubled debt restructuring | 1,420   | 10,201                          | -                                      | -                | -                       | -                 | 11,621            |
| <b>Total ending loans balance</b>               | <b>\$ 257,091</b>                                       | <b>\$ 261,791</b>               | <b>\$ 347,904</b>                      | <b>\$ 58,668</b> | <b>\$ 4,800</b>         | <b>\$ 971</b>     | <b>\$ 931,225</b> |
| <br>  |   |                                 |  |                  |                         |                   |                   |
| <b>December 31, 2011</b>                        | <b>Commercial,<br/>Industrial, and<br/>Agricultural</b> | <b>Commercial<br/>Mortgages</b> | <b>Residential<br/>Real<br/>Estate</b> | <b>Consumer</b>  | <b>Credit<br/>Cards</b> | <b>Overdrafts</b> | <b>Total</b>      |
| <b>Allowance for loan losses:</b>               |   |                                 |  |                  |                         |                   |                   |
| Ending allowance balance attributable to loans: |   |                                 |  |                  |                         |                   |                   |
| Individually evaluated for impairment           | \$ 329  | \$ 917                          | \$ 19                                  | \$ -             | \$ -                    | \$ -              | \$ 1,265          |
| Collectively evaluated for impairment           | 4,182   | 3,325                           | 1,972                                  | 1,404            | 71                      | 168               | 11,122            |
| Modified in a troubled debt restructuring       | -   | 228                             | -                                      | -                | -                       | -                 | 228               |
| <b>Total ending allowance balance</b>           | <b>\$ 4,511</b>   | <b>\$ 4,470</b>                 | <b>\$ 1,991</b>                        | <b>\$ 1,404</b>  | <b>\$ 71</b>            | <b>\$ 168</b>     | <b>\$ 12,615</b>  |
| <b>Loans:</b>                                   |   |                                 |  |                  |                         |                   |                   |
| Loans individually evaluated for impairment     | \$ 6,115  | \$ 8,457                        | \$ 124                                 | \$ -             | \$ -                    | \$ -              | \$ 14,696         |
| Loans collectively evaluated for impairment     | 247,209   | 226,366                         | 298,504                                | 53,471           | 4,412                   | 423               | 830,385           |
| Loans modified in a troubled debt restructuring | -   | 7,688                           | -                                      | -                | -                       | -                 | 7,688             |
| <b>Total ending loans balance</b>               | <b>\$ 253,324</b>                                       | <b>\$ 242,511</b>               | <b>\$ 298,628</b>                      | <b>\$ 53,471</b> | <b>\$ 4,412</b>         | <b>\$ 423</b>     | <b>\$ 852,769</b> |



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The recorded investment in loans within the tables above and below excludes accrued interest receivable and unearned discount due to immateriality.

The following tables present information related to loans individually evaluated for impairment by portfolio segment as of December 31, 2012 and 2011 and for the years ended December 31, 2012, 2011, and 2010:

**December 31, 2012**

|  | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Allowance<br>for Loan<br>Losses<br>Allocated |
|--|--------------------------------|------------------------|--|
| <b>With an allowance recorded:</b>         |                                |                        |  |
| Commercial, industrial, and agricultural   | \$ 2,542                       | \$ 1,792               | \$ 541                                       |
| Commercial mortgage                        | 5,870                          | 5,329                  | 1,230  |
| Residential real estate                    | 416                            | 381                    | 81   |
| <b>With no related allowance recorded:</b> |                                |                        |  |
| Commercial, industrial, and agricultural   | 2,804                          | 2,251                  | -  |
| Commercial mortgage                        | 17,285                         | 15,555                 | -  |
| Residential real estate                    | 308                            | 212                    | -  |
| <b>Total</b>                               | <b>\$ 29,225</b>               | <b>\$ 25,520</b>       | <b>\$ 1,852</b>                              |
| <b>With an allowance recorded:</b>         |                                |                        |  |
| Commercial, industrial, and agricultural   | \$ 4,329                       | \$ 2,815               | \$ 329                                       |
| Commercial mortgage                        | 4,724                          | 4,065                  | 1,145  |
| Residential real estate                    | 187                            | 124                    | 19   |
| <b>With no related allowance recorded:</b> |                                |                        |  |
| Commercial, industrial, and agricultural   | 3,892                          | 3,300                  | -  |
| Commercial mortgage                        | 13,839                         | 12,080                 | -  |
| Residential real estate                    | -                              | -                      | -  |
| <b>Total</b>                               | <b>\$ 26,971</b>               | <b>\$ 22,384</b>       | <b>\$ 1,493</b>                              |

The unpaid principal balance of impaired loans includes the Corporation's recorded investment in the loan and amounts that have been charged off.

|  | Year Ended |                   |            |
|--|------------|-------------------|------------|
|  | Average    | December 31, 2012 | Cash Basis |
|  | Recorded   | Interest          | Interest   |
|  | Investment | Recognized        | Recognized |
| <b>With an allowance recorded:</b>         |            |                   |            |
| Commercial, industrial, and agricultural   | \$ 3,083   | \$ 4              | \$ 4       |
| Commercial mortgage                        | 5,504      | 3                 | 3          |
| Residential real estate                    | 334        | 13                | 13         |
| <b>With no related allowance recorded:</b> |            |                   |            |
| Commercial, industrial, and agricultural   | 3,217      | -                 | -          |
| Commercial mortgage                        | 12,723     | -                 | -          |

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|                         |           |       |       |
|-------------------------|-----------|-------|-------|
| Residential real estate | 103       | -     | -     |
| Total                   | \$ 24,964 | \$ 20 | \$ 20 |

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|  | Year Ended        |              |              |
|--|-------------------|--------------|--------------|
|  | December 31, 2011 |              |              |
|  | Average           | Interest     | Cash Basis   |
|  | Recorded          | Income       | Interest     |
|  | Investment        | Recognized   | Recognized   |
| <b>With an allowance recorded:</b>         |                   |              |              |
| Commercial, industrial, and agricultural   | \$ 3,711          | \$ 3         | \$ 3         |
| Commercial mortgage                        | 6,412             | 19           | 19           |
| Residential real estate                    | 179               | 4            | 4            |
| <b>With no related allowance recorded:</b> |                   |              |              |
| Commercial, industrial, and agricultural   | 2,050             | -            | -            |
| Commercial mortgage                        | 6,040             | -            | -            |
| Residential real estate                    | -                 | -            | -            |
| <b>Total</b>                               | <b>\$ 18,392</b>  | <b>\$ 26</b> | <b>\$ 26</b> |

|   | Year ended December 31, 2010 |
|---|------------------------------|
| Average recorded investment in impaired loans | \$ 12,106                    |
| Interest income recognized during impairment  | 383                          |
| Cash-basis interest income recognized         | 383                          |

The following table presents the recorded investment in nonaccrual loans and loans past due over 90 days still on accrual by class of loans as of December 31, 2012 and 2011:

|  | December 31, 2012 |  | December 31, 2011 |  |
|--|-------------------|--|-------------------|--|
|  | Nonaccrual        | Past Due<br>Over 90 Days<br>Still on Accrual | Nonaccrual        | Past Due<br>Over 90 Days<br>Still on Accrual |
| Commercial, industrial, and agricultural | \$ 3,073          | \$ -   | \$ 6,949          | \$ 10  |
| Commercial mortgages                     | 8,570             | 109  | 8,359             | 122  |
| Residential real estate                  | 2,792             | 18   | 1,254             | 157  |
| Consumer                                 | 10                | 217  | 5                 | 125  |
| Credit cards                             | -                 | 13   | -                 | 27   |
| <b>Total</b>                             | <b>\$ 14,445</b>  | <b>\$ 357</b>                                | <b>\$ 16,567</b>  | <b>\$ 441</b>                                |

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



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The following table presents the aging of the recorded investment in past due loans as of December 31, 2012 and 2011 by class of loans.

|  | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | Greater Than<br>90 Days<br>Past Due | Total<br>Past<br>Due | Loans Not<br>Past Due | Total             |
|--|------------------------|------------------------|-------------------------------------|----------------------|-----------------------|-------------------|
| <b>December 31, 2012</b>                 |                        |                        |                                     |                      |                       |                   |
| Commercial, industrial, and agricultural | \$ 724                 | \$ 157                 | \$ 2,968                            | \$ 3,849             | \$ 253,242            | \$ 257,091        |
| Commercial mortgages                     | 1,162                  | 3,197                  | 8,679                               | 13,038               | 248,753               | 261,791           |
| Residential real estate                  | 1,390                  | 641                    | 2,700                               | 4,731                | 343,173               | 347,904           |
| Consumer                                 | 724                    | 203                    | 227                                 | 1,154                | 57,514                | 58,668            |
| Credit cards                             | 39                     | 9                      | 13                                  | 61                   | 4,739                 | 4,800             |
| Overdrafts                               | -                      | -                      | -                                   | -                    | 971                   | 971               |
| <b>Total</b>                             | <b>\$ 4,039</b>        | <b>\$ 4,207</b>        | <b>\$ 14,587</b>                    | <b>\$ 22,833</b>     | <b>\$ 908,392</b>     | <b>\$ 931,225</b> |
| <b>December 31, 2011</b>                 |                        |                        |                                     |                      |                       |                   |
| Commercial, industrial, and agricultural | \$ 239                 | \$ 53                  | \$ 6,959                            | \$ 7,251             | \$ 246,073            | \$ 253,324        |
| Commercial mortgages                     | 1,064                  | 2,620                  | 7,043                               | 10,727               | 231,784               | 242,511           |
| Residential real estate                  | 1,816                  | 682                    | 1,411                               | 3,909                | 294,719               | 298,628           |
| Consumer                                 | 392                    | 185                    | 130                                 | 707                  | 52,764                | 53,471            |
| Credit cards                             | 34                     | 19                     | 27                                  | 80                   | 4,332                 | 4,412             |
| Overdrafts                               | -                      | -                      | -                                   | -                    | 423                   | 423               |
| <b>Total</b>                             | <b>\$ 3,545</b>        | <b>\$ 3,559</b>        | <b>\$ 15,570</b>                    | <b>\$ 22,674</b>     | <b>\$ 830,095</b>     | <b>\$ 852,769</b> |

**Troubled Debt Restructurings**

During the years ended December 31, 2012 and 2011, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included either or both of the following: a reduction of the stated interest rate of the loan; or an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk.

The following table presents the number of loans, loan balances, and specific reserves for loans that have been restructured in a troubled debt restructuring as of December 31, 2012 and December 31, 2011.

|  | December 31, 2012     |                  |                     | December 31, 2011     |                 |                     |
|--|-----------------------|------------------|---------------------|-----------------------|-----------------|---------------------|
|  | Number<br>of<br>Loans | Loan<br>Balance  | Specific<br>Reserve | Number<br>of<br>Loans | Loan<br>Balance | Specific<br>Reserve |
| Commercial, industrial, and agricultural | 2                     | \$ 1,420         | \$ -                | -                     | \$ -            | \$ -                |
| Commercial mortgages                     | 8                     | 10,201           | 1,099               | 3                     | 7,688           | 228                 |
| Residential real estate                  | -                     | -                | -                   | -                     | -               | -                   |
| Consumer                                 | -                     | -                | -                   | -                     | -               | -                   |
| Credit cards                             | -                     | -                | -                   | -                     | -               | -                   |
| <b>Total</b>                             | <b>10</b>             | <b>\$ 11,621</b> | <b>\$ 1,099</b>     | <b>3</b>              | <b>\$ 7,688</b> | <b>\$ 228</b>       |

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The following table presents loans by class modified as troubled debt restructurings that occurred during the years ended December 31, 2012 and 2011:

|  | Number of<br>Loans | Year Ended December 31, 2012                           |   |
|--|--------------------|--|---|
|  |                    | Pre-Modification<br>Outstanding Recorded<br>Investment | Post-Modification<br>Outstanding Recorded<br>Investment |
| Commercial, industrial, and agricultural | 2                  | \$ 1,455   | \$ 1,455  |
| Commercial mortgages                     | 5                  | 2,717  | 2,717   |
| Residential real estate                  | -                  | -  | -   |
| Consumer                                 | -                  | -  | -   |
| Credit cards                             | -                  | -  | -   |
| <b>Total</b>                             | <b>7</b>           | <b>\$ 4,172</b>  | <b>\$ 4,172</b>   |

|  | Number<br>of<br>Loans | Year Ended December 31, 2011                              |  |
|--|-----------------------|---|--|
|  |                       | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment |
| Commercial, industrial, and agricultural | -                     | \$ -  | \$ -   |
| Commercial mortgages                     | 2                     | 6,041   | 6,041  |
| Residential real estate                  | -                     | -   | -  |
| Consumer                                 | -                     | -   | -  |
| Credit cards                             | -                     | -   | -  |
| <b>Total</b>                             | <b>2</b>              | <b>\$ 6,041</b>   | <b>\$ 6,041</b>  |

The troubled debt restructurings described above increased the allowance for loan losses by \$101 and \$0 during the years ended December 31, 2012 and 2011, respectively.

Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from 4-15 years. Modifications involving an extension of the maturity date were for periods ranging from 4-18 years.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms. Except as discussed below, all loans modified in troubled debt restructurings are performing in accordance with their modified terms as of December 31, 2012 and 2011 and no principal balances were forgiven in connection with the loan restructurings. During the year ended December 31, 2012, one commercial mortgage loan with a balance of \$1,660 defaulted under its restructured terms and was placed on nonaccrual status, resulting in an increase in the allowance for loan losses of \$503. No loans that were modified in a troubled debt restructuring were charged off during the years ended December 31, 2012 and 2011.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without a loan modification. This evaluation is performed using the Corporation's internal underwriting policies. The Corporation has no further loan commitments to customers whose loans are classified as a troubled debt restructuring.

**Table of Contents****Credit Quality Indicators**

The Corporation classifies commercial, industrial, and agricultural loans and commercial mortgage loans into risk categories based on relevant information about the ability of borrowers to service their debt, such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Corporation analyzes loans individually by classifying the loans as to credit risk. This analysis includes loans with an outstanding balance greater than \$1 million bi-annually and loans with an outstanding balance of less than \$1 million at least annually.

The Corporation uses the following definitions for risk ratings:

**Special Mention:** Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Corporation's credit position at some future date.

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

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

Loans not rated as special mention, substandard, or doubtful are considered to be pass rated loans. All loans included in the following tables have been assigned a risk rating within 12 months of the balance sheet date.

|  | Pass              | Special<br>Mention | Substandard      | Doubtful      | Total             |
|--|-------------------|--------------------|------------------|---------------|-------------------|
| <b>December 31, 2012</b>                 |                   |                    |                  |               |                   |
| Commercial, industrial, and agricultural | \$ 234,835        | \$ 6,641           | \$ 15,459        | \$ 156        | \$ 257,091        |
| Commercial mortgages                     | 225,294           | 12,294             | 23,501           | 702           | 261,791           |
| <b>Total</b>                             | <b>\$ 460,129</b> | <b>\$ 18,935</b>   | <b>\$ 38,960</b> | <b>\$ 858</b> | <b>\$ 518,882</b> |

|  | Pass              | Special<br>Mention | Substandard      | Doubtful      | Total             |
|--|-------------------|--------------------|------------------|---------------|-------------------|
| <b>December 31, 2011</b>                 |                   |                    |                  |               |                   |
| Commercial, industrial, and agricultural | \$ 223,457        | \$ 4,176           | \$ 25,490        | \$ 201        | \$ 253,324        |
| Commercial mortgages                     | 214,098           | 3,172              | 24,513           | 728           | 242,511           |
| <b>Total</b>                             | <b>\$ 437,555</b> | <b>\$ 7,348</b>    | <b>\$ 50,003</b> | <b>\$ 929</b> | <b>\$ 495,835</b> |

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The Corporation considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential real estate, consumer, and credit card loan classes, the Corporation also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in residential and consumer loans based on payment activity as of December 31, 2012 and 2011:

|                | December 31, 2012          |                  |                 | December 31, 2011          |                  |                 |
|----------------|----------------------------|------------------|-----------------|----------------------------|------------------|-----------------|
|                | Residential<br>Real Estate | Consumer         | Credit<br>Cards | Residential<br>Real Estate | Consumer         | Credit<br>Cards |
| Performing     | \$ 345,094                 | \$ 58,441        | \$ 4,787        | \$ 297,217                 | \$ 53,341        | \$ 4,385        |
| Non-performing | 2,810                      | 227              | 13              | 1,411                      | 130              | 27              |
| <b>Total</b>   | <b>\$ 347,904</b>          | <b>\$ 58,668</b> | <b>\$ 4,800</b> | <b>\$ 298,628</b>          | <b>\$ 53,471</b> | <b>\$ 4,412</b> |

The Corporation's portfolio of residential real estate and consumer loans maintained within Holiday, a subsidiary that offers small balance unsecured and secured loans, primarily collateralized by automobiles and equipment, to borrowers with higher risk characteristics than are typical in the Bank's consumer loan portfolio, are considered to be subprime loans. The Bank does not have any subprime loans. Holiday's loan portfolio is summarized as follows at December 31, 2012 and 2011:

|                         | 2012             | 2011             |
|-------------------------|------------------|------------------|
| Consumer                | \$ 21,535        | \$ 18,176        |
| Residential real estate | 954              | 1,056            |
| Less: unearned discount | (3,401)          | (2,886)          |
| <b>Total</b>            | <b>\$ 19,088</b> | <b>\$ 16,346</b> |

**5. Secondary Market Mortgage Activities**

The following summarizes secondary market mortgage activities for the years ended December 31, 2012, 2011, and 2010:

|   | 2012      | 2011      | 2010      |
|---|-----------|-----------|-----------|
| Loans originated for resale, net of principal pay downs | \$ 32,626 | \$ 19,927 | \$ 28,706 |
| Proceeds from sales of loans held for sale              | 32,512    | 23,324    | 22,585    |
| Net gains on sales of loans held for sale               | 927       | 638       | 688       |
| Loan servicing fees                                     | 340       | 349       | 349       |

Total loans serviced for others was \$104,017, \$109,006, and \$106,265 at December 31, 2012, 2011, and 2010, respectively.

The following summarizes activity for capitalized mortgage servicing rights for the years ended December 31, 2012, 2011, and 2010:

|                             | 2012          | 2011          | 2010          |
|-----------------------------|---------------|---------------|---------------|
| Balance, beginning of year  | \$ 906        | \$ 909        | \$ 876        |
| Additions                   | 85            | 249           | 256           |
| Amortization                | (277)         | (252)         | (223)         |
| <b>Balance, end of year</b> | <b>\$ 714</b> | <b>\$ 906</b> | <b>\$ 909</b> |



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The fair value of mortgage servicing rights is based on market prices for comparable mortgage servicing contracts, when available, or alternatively based on a valuation model that calculates the present value of estimated future net servicing income. The fair value of mortgage servicing rights was \$718, \$959, and \$1,010 at December 31, 2012, 2011, and 2010, respectively. No valuation allowance is deemed necessary at December 31, 2012, 2011, or 2010. The fair value of interest rate lock commitments was not material at December 31, 2012 or 2011.

**6. Premises and Equipment**

The following summarizes premises and equipment at December 31, 2012 and 2011:

|                                     | 2012      | 2011      |
|-------------------------------------|-----------|-----------|
| Land                                | \$ 4,126  | \$ 4,122  |
| Premises and leasehold improvements | 25,670    | 25,263    |
| Furniture and equipment             | 17,522    | 16,257    |
| Construction in progress            | 408       | 104       |
|                                     | 47,726    | 45,746    |
| Less: accumulated depreciation      | 23,654    | 21,742    |
| Premises and equipment, net         | \$ 24,072 | \$ 24,004 |

Depreciation on premises and equipment amounted to \$1,948 in 2012, \$1,823 in 2011, and \$1,726 in 2010.

The Corporation is committed under fourteen noncancelable operating leases for facilities with initial or remaining terms in excess of one year. The minimum annual rental commitments under these leases at December 31, 2012 are as follows:

|            |          |
|------------|----------|
| 2013       | \$ 402   |
| 2014       | 369      |
| 2015       | 348      |
| 2016       | 339      |
| 2017       | 248      |
| Thereafter | 1,209    |
|            | \$ 2,915 |

Rental expense, net of rental income, charged to occupancy expense for 2012, 2011, and 2010 was \$351, \$349, and \$368, respectively.

In December 2009, the Corporation entered into a sale-leaseback transaction for real estate used in the operations of one of its branch office locations. The lease term is seventeen years, with two automatic renewal terms of five years each. The Corporation sold the property for \$1,200 but financed the entire sales amount. Because the buyer/lessor did not make an initial investment on the purchase of the real estate that is adequate to transfer the risks and rewards of ownership, the Corporation deferred the entire gain of \$489 associated with this transaction, which is included in accrued interest payable and other liabilities in the accompanying consolidated balance sheet. The gain is being recognized over the term of the loan under the installment method, and the gain recognized was included in other income in the accompanying consolidated statements of income and comprehensive income and totaled \$19, \$16, and \$14 in 2012, 2011, and 2010, respectively.

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The minimum annual rental commitments under this lease at December 31, 2012 are as follows:

|            |    |       |
|------------|----|-------|
| 2013       | \$ | 112   |
| 2014       |    | 112   |
| 2015       |    | 112   |
| 2016       |    | 112   |
| 2017       |    | 112   |
| Thereafter |    | 1,005 |
|            | \$ | 1,565 |

**7. Foreclosed Assets**

Foreclosed real estate is reported net of a valuation allowance and included in accrued interest receivable and other assets in the accompanying consolidated balance sheets. Activity for the years ended December 31, 2012, 2011, and 2010 is as follows:

|                            | 2012   | 2011   | 2010   |
|----------------------------|--------|--------|--------|
| Balance, beginning of year | \$ 505 | \$ 396 | \$ 252 |
| Additions                  | 750    | 249    | 453    |
| Sales (at carrying value)  | (930)  | (140)  | (309)  |
| Balance, end of year       | \$ 325 | \$ 505 | \$ 396 |

Expenses related to foreclosed real estate include:

|  | 2012     | 2011     | 2010     |
|--|----------|----------|----------|
| Net loss (gain) on sale                  | \$ (158) | \$ (101) | \$ (117) |
| Operating expenses, net of rental income | 176      | 24       | 69       |
|  | \$ 18    | \$ (77)  | \$ (48)  |

**8. Goodwill**

The change in the carrying amount of goodwill for the years ended December 31, 2012 and 2011 is as follows:

|                            | 2012      | 2011      |
|----------------------------|-----------|-----------|
| Balance, beginning of year | \$ 10,821 | \$ 10,821 |
| Acquired during the year   | 125       | -         |
| Balance, end of year       | \$ 10,946 | \$ 10,821 |

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In the third quarter of 2012, the Corporation purchased the loans and other assets of a consumer discount company in Ebensburg, Pennsylvania. The purchase price was \$1,248 for the performing loans and customers of the business. The purchase price resulted in the Corporation recording a \$75 customer relationship intangible asset which is being amortized using the straight-line method over three years. This amount is included in accrued interest receivable and other assets on the consolidated



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balance sheet. Goodwill of \$125 was also recorded in connection with the acquisition. Due to the insignificance of the assets acquired in relation to the consolidated financial statements as a whole, no further business combination or intangible asset disclosures are included in the notes to consolidated financial statements.

Impairment exists when a reporting unit's carrying value of goodwill exceeds its fair value, which is determined through a two-step impairment test. Step 1 includes the determination of the carrying value of our single reporting unit, including the existing goodwill and intangible assets, and estimating the fair value of the reporting unit. We determined the fair value of our reporting unit exceeded its carrying amount. If the carrying amount of the reporting unit exceeds its fair value, we are required to perform a second step to the impairment test. Our annual impairment analysis at December 31, 2012 and 2011 indicated that the Step 2 analysis was not necessary.

**9. Deposits**

The following table reflects time certificates of deposit accounts included in total deposits and their remaining maturities at December 31, 2012:

|                         |           |
|-------------------------|-----------|
| Time deposits maturing: |           |
| 2013                    | \$ 71,033 |
| 2014                    | 60,010    |
| 2015                    | 34,277    |
| 2016                    | 20,169    |
| 2017                    | 15,818    |
| Thereafter              | 11,636    |

\$ 212,943

Certificates of deposit of \$100 thousand or more totaled \$87,018 and \$115,572 at December 31, 2012 and 2011, respectively.

**Table of Contents****10. Borrowings**

The Corporation has available one \$9 million line of credit with an unaffiliated institution, with a floating rate of 30 day LIBOR plus 180 basis points and a floor of 3.50%, which was in effect at both December 31, 2012 and 2011. There were no borrowings on the line at December 31, 2012 and 2011.

**FHLB Borrowings**

At December 31, 2012, the Bank had remaining borrowing capacity with the FHLB of \$357,523. At December 31, 2012, borrowings with the FHLB are secured by a blanket pledge of selected securities in the amount of \$130,842 and certain loans with a balance of \$470,422 at December 31, 2012. Borrowings from the FHLB at December 31, 2012 and 2011 are as follows:

| Interest Rate | Maturity | 2012      | 2011      |
|---------------|----------|-----------|-----------|
| (a)           | 09/17/15 | \$ 20,000 | \$ 20,000 |
| (b)           | 06/01/17 | 10,000    | 10,000    |
| (c)           | 08/07/17 | 5,000     | 5,000     |
| (d)           | 08/07/17 | 5,000     | 5,000     |
| (e)           | 08/07/17 | 10,000    | 10,000    |
| (f)           | 10/10/17 | 10,000    | 10,000    |
| (g)           | 07/07/23 | 700       | 700       |
| (h)           | 09/05/23 | 2,388     | 2,491     |
| (i)           | 06/11/24 | 557       | 578       |
| (j)           | 05/24/26 | 321       | 340       |
| (k)           | 10/14/26 | 330       | 347       |
|               |          | \$ 64,296 | \$ 64,456 |

(a), (g) Fixed rate borrowings at interest rates of 2.09% and 4.72%, respectively.

(b) Interest rate was fixed at 4.60% until June 2009, since which time FHLB has had the option to convert to floating interest rate based on the 3 month LIBOR + 0.16%. The interest rate was 4.60% at December 31, 2012 and 2011.

(c) Interest rate was fixed at 4.02% until February 2008, since which time FHLB has had the option to convert to a floating interest rate based on the 3 month LIBOR + 0.11%. The interest rate was 4.02% at December 31, 2012 and 2011.

(d) Interest rate was fixed at 4.10% until August 2008, since which time FHLB has had the option to convert to a floating interest rate based on the 3 month LIBOR + 0.11%. The interest rate was 4.10% at December 31, 2012 and 2011.

(e) Interest rate is fixed at 4.47% until August 2010, since which time FHLB has had the option to convert to a floating interest rate based on the 3 month LIBOR + 0.11%. The interest rate was 4.47% at December 31, 2012 and 2011.

(f) Interest rate was fixed at 3.97% until October 2009, since which time FHLB has had the option to convert to a floating interest rate based on the 3 month LIBOR + 0.10%. The interest rate was 3.97% at December 31, 2012 and 2011.

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- (h) Fixed rate borrowing at an interest rate of 4.31%, with monthly principal and interest payments and a balloon payment due at maturity.
- (i) Fixed rate borrowing at an interest rate of 5.24%, with monthly principal and interest payments and a balloon payment due at maturity.
- (j) Fixed rate borrowing at an interest rate of 3.35%, with monthly principal and interest payments.
- (k) Fixed rate borrowing at an interest rate of 4.00%, with monthly principal and interest payments.

The terms of borrowings (a) through (g) are interest only payments with principal due at maturity.

Each advance is payable at its maturity date, with a prepayment penalty for fixed rate advances.

### **Other Borrowings**

At December 31, 2012, the Bank had outstanding borrowings of \$23,510 from one unaffiliated institution under an overnight borrowing agreement. The interest rate on this borrowing was 0.35%. The Bank had no overnight borrowings at December 31, 2011.

The Bank entered into a borrowing transaction with an unaffiliated institution in March 2007. The proceeds of this borrowing were \$10,000 and, as part of this transaction, the Bank pledged certain securities which had a carrying amount of \$12,585 at December 31, 2012. The borrowing has a maturity date of March 20, 2017 and a variable interest rate of 3 month LIBOR minus 1.0% through March 20, 2008, at which time the interest rate became fixed as defined. The borrowing is callable by the issuer at the end of each quarter until maturity. The interest rate was 5.25% at December 31, 2012 and 2011, which will be the interest rate through the term of the borrowing.

### **Subordinated Debentures**

In 2007, the Corporation issued two \$10,000 floating rate trust preferred securities as part of a pooled offering of such securities. The interest rate on each offering is determined quarterly and floats based on the 3 month LIBOR plus 1.55% and was 1.86% and 2.10% at December 31, 2012 and 2011, respectively. The Corporation issued subordinated debentures to the trusts in exchange for the proceeds of the offerings, which debentures represent the sole assets of the trusts. The subordinated debentures must be redeemed no later than 2037. The Corporation may redeem the debentures, in whole or in part, at face value at any time. The Corporation has the option to defer interest payments from time to time for a period not to exceed five consecutive years.

Although the trusts are variable interest entities, the Corporation is not the primary beneficiary. As a result, because the trusts are not consolidated with the Corporation, the Corporation does not report the securities issued by the trusts as liabilities. Instead, the Corporation reports as liabilities the subordinated debentures issued by the Corporation and held by the trusts, since the liabilities are not eliminated in consolidation.

**Table of Contents****Maturity Schedule of All Borrowed Funds**

The following is a schedule of maturities of all borrowed funds as of December 31, 2012:

|            |           |
|------------|-----------|
| 2013       | \$ 23,677 |
| 2014       | 175       |
| 2015       | 20,183    |
| 2016       | 191       |
| 2017       | 50,199    |
| Thereafter | 24,001    |

|                      |            |
|----------------------|------------|
| Total borrowed funds | \$ 118,426 |
|----------------------|------------|

**11. Interest Rate Swaps**

On August 1, 2008, the Corporation executed an interest rate swap agreement with a 5 year term and an effective date of September 15, 2008 in order to hedge \$10 million of a subordinated note that was issued by the Corporation during 2007 and elected cash flow hedge accounting for the agreement. The Corporation's objective in using this derivative is to add stability to interest expense and cash flows, and to manage its exposure to interest rate risk. The interest rate swap involves the receipt of variable-rate amounts in exchange for fixed-rate payments from August 1, 2008 to September 15, 2013 without exchange of the underlying notional amount. At December 31, 2012 and 2011, the variable rate on the subordinated debt was LIBOR plus 155 basis points (1.86% and 2.10% at December 31, 2012 and 2011, respectively) and the Corporation was paying 5.84% (4.29% fixed rate plus 155 basis points).

In anticipation of the expiration of the 5 year interest rate swap agreement discussed immediately above, on May 3, 2011, the Corporation executed an interest rate swap agreement with a 5 year term and an effective date of September 15, 2013 which as of that effective date, will hedge \$10 million of the subordinated note discussed immediately above. As with the prior interest rate swap agreement, the Corporation's objective in using this derivative is to add stability to interest expense and to manage its exposure to interest rate risk. The interest rate swap involves the receipt of variable-rate amounts in exchange for fixed-rate payments from September 15, 2013 to September 15, 2018 without exchange of the underlying notional amount. On the effective date, the variable rate on the subordinated debt will be LIBOR plus 155 basis points and the Corporation will be paying 5.57% (4.02% fixed rate plus 155 basis points).

As of December 31, 2012 and 2011, no derivatives were designated as fair value hedges or hedges of net investments in foreign operations. Additionally, the Corporation does not use derivatives for trading or speculative purposes and currently does not have any derivatives that are not designated as hedges.

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The following tables provide information about the amounts and locations of activity related to the interest rate swaps designated as cash flow hedges within the Corporation's consolidated balance sheet and statement of income as of December 31, 2012 and 2011 and for the years ended December 31, 2012, 2011, and 2010:

| As of December 31         | Liability Derivative                   |  |
|---------------------------|--|--|
|                           | Balance Sheet Location                 | Fair value                                       |
| Interest rate contract    | Accrued interest and other liabilities | 2012 2011<br>(\$1,745) (\$1,669)                 |
| <b>For the Year Ended</b> |  |  |
| <b>December 31, 2012</b>  | (a)                                    | (b)  |
| Interest rate contract    | (\$49)                                 | Interest expense subordinated debentures (\$390) |
| <b>For the Year Ended</b> |  |  |
| <b>December 31, 2011</b>  | (c)                                    | (d)  |
| Interest rate contract    | (\$522)                                | Interest expense subordinated debentures (\$402) |
| <b>For the Year Ended</b> |  |  |
| <b>December 31, 2010</b>  | (e)                                    |  |
| Interest rate contract    | (\$107)                                | Interest expense subordinated debentures (\$401) |

- (a) Amount of Gain or (Loss) Recognized in Other Comprehensive Loss on Derivative (Effective Portion), net of tax
- (b) Location of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)
- (c) Amount of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)
- (d) Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
- (e) Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)

Amounts reported in accumulated other comprehensive loss related to the interest rate swap will be reclassified to interest expense as interest payments are made on the subordinated debentures. Such amounts reclassified from accumulated other comprehensive loss to interest expense in the next twelve months are expected to be \$390.

As of December 31, 2012 and 2011, a cash collateral balance in the amount of \$1,950 and \$1,850, respectively, was maintained with the counterparty to the interest rate swaps. These balances are included in interest bearing deposits with other banks on the consolidated balance sheets.



**Table of Contents****12. Income Taxes**

The following is a summary of income tax expense for the years ended December 31, 2012, 2011, and 2010:

|                    | 2012     | 2011     | 2010     |
|--------------------|----------|----------|----------|
| Current federal    | \$ 6,535 | \$ 4,951 | \$ 1,121 |
| Current state      | 116      | 137      | 97       |
| Deferred - federal | (240)    | 441      | 2,251    |
| Income tax expense | \$ 6,411 | \$ 5,529 | \$ 3,469 |

The components of the net deferred tax liability as of December 31, 2012 and 2011 are as follows:

|  | 2012       | 2011       |
|--|------------|------------|
| <b>Deferred tax assets:</b>                      |            |            |
| Allowance for loan losses                        | \$ 4,632   | \$ 4,336   |
| Deferred compensation                            | 1,753      | 1,542      |
| Impaired security valuation                      | 670        | 495        |
| Capital loss carryover                           | 278        | 435        |
| Post-retirement benefits                         | 1,063      | 826        |
| Unrealized loss on interest rate swap            | 616        | 584        |
| Nonaccrual loan interest                         | 305        | 455        |
| Other  | 609        | 515        |
|  | 9,926      | 9,188      |
| <b>Deferred tax liabilities:</b>                 |            |            |
| Unrealized gain on securities available for sale | 8,636      | 6,720      |
| Premises and equipment                           | 1,535      | 1,561      |
| Intangibles section 197                          | 3,179      | 2,837      |
| Mortgage servicing rights                        | 250        | 317        |
| Other  | 339        | 308        |
|  | 13,939     | 11,743     |
| Net deferred tax liability                       | (\$ 4,013) | (\$ 2,555) |

At December 31, 2012, the Corporation had a federal capital loss carryforward of \$793 that will expire in 2015 if not used. The Corporation determined that it was not required to establish a valuation allowance for deferred tax assets. Management believes that the deferred tax assets relating to the capital loss carryforward is likely to be realized through a tax planning strategy to generate capital gains in the carryforward period.

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The reconciliation of income tax attributable to pre-tax income at the federal statutory tax rates to income tax expense is as follows:

|                              | 2012            | %           | 2011            | %           | 2010            | %           |
|------------------------------|-----------------|-------------|-----------------|-------------|-----------------|-------------|
| Tax at statutory rate        | \$ 8,241        | 35.0        | \$ 7,222        | 35.0        | \$ 5,175        | 35.0        |
| Tax exempt income,<br>net    | (1,553)         | (6.6)       | (1,353)         | (6.6)       | (1,281)         | (8.7)       |
| Bank owned life<br>insurance | (341)           | (1.4)       | (325)           | (1.6)       | (281)           | (1.9)       |
| Other                        | 64              | 0.2         | (15)            | -           | (144)           | (0.9)       |
| <b>Income tax expense</b>    | <b>\$ 6,411</b> | <b>27.2</b> | <b>\$ 5,529</b> | <b>26.8</b> | <b>\$ 3,469</b> | <b>23.5</b> |

At December 31, 2012 and 2011, the Corporation has no unrecognized tax benefits. The Corporation does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months.

The Corporation recognizes interest and/or penalties related to income tax matters as part of income tax expense. At December 31, 2012 and 2011, there were no amounts accrued for interest and/or penalties.

The Corporation and its subsidiaries are subject to U.S. federal income tax as well as income tax of the Commonwealth of Pennsylvania. During 2010, the Corporation's 2006, 2007, and 2008 federal examinations closed with no material impact to the Corporation's income or financial position. The Corporation is no longer subject to examination by the taxing authorities for years prior to 2009. Tax years 2009 through 2011 remain open to federal and state examination.

### 13. Employee Benefit Plans

The Corporation sponsors a contributory defined contribution Section 401(k) plan in which substantially all employees participate. The plan permits employees to make pre-tax contributions which are matched by the Corporation at 100% for every 1% contributed up to three percent then 50% for every 1% contributed up to the next four percent in total of the employee's compensation. The Corporation's contributions were \$397, \$385, and \$350 in 2012, 2011, and 2010, respectively. Profit sharing contributions to this plan, based on current year compensation, are 6 percent of total compensation plus 5.7 percent of the compensation in excess of \$110. The Corporation recognized profit sharing expense of \$783, \$667, and \$641 in 2012, 2011, and 2010 respectively.

The Corporation has adopted a non-qualified supplemental executive retirement plan (SERP) for certain executives to compensate those executive participants in the Corporation's retirement plan whose benefits are limited by compensation limitations under current tax law. The SERP is considered an unfunded plan for tax and ERISA purposes and all obligations arising under the SERP are payable from the general assets of the Corporation. At December 31, 2012 and 2011, obligations of \$3,792 and \$3,276, respectively, were included in other liabilities for this plan. Expenses related to this plan were \$728 in 2012, \$647 in 2011, and \$227 in 2010.

The Corporation has established a Survivor Benefit Plan for the benefit of outside directors. The purpose of the plan is to provide life insurance benefits to beneficiaries of the Corporation's directors who at the time of their death are participants in the plan. The plan is considered an unfunded plan for tax and ERISA purposes and all obligations arising under the plan are payable from the general assets



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of the Corporation. At December 31, 2012 and 2011, obligations of \$813 and \$686, respectively, were included in other liabilities for this plan. Expenses related to this plan were \$127 in 2012, \$106 in 2011, and \$21 in 2010.

The Corporation has an unfunded post retirement benefits plan which provides certain health care benefits for retired employees who have reached the age of 60 and retired with 30 years of service. Benefits are provided for these retired employees and their qualifying dependents from the age of 60 through the age of 65.

The following table sets forth the change in the benefit obligation of the plan as of and for the years ended December 31, 2012, 2011, and 2010:

|   | 2012     | 2011     | 2010     |
|---|----------|----------|----------|
| Benefit obligation at beginning of year | \$ 1,674 | \$ 1,073 | \$ 783   |
| Interest cost                           | 69       | 56       | 43       |
| Service cost                            | 88       | 49       | 34       |
| Actual claim expense                    | (184)    | (262)    | (167)    |
| Actuarial loss                          | 577      | 758      | 380      |
| Benefit obligation at end of year       | \$ 2,224 | \$ 1,674 | \$ 1,073 |

Amounts recognized in accumulated other comprehensive income at December 31, 2012 and 2011 consist of:

|                       | 2012       | 2011     |
|-----------------------|------------|----------|
| Net actuarial loss    | \$ (1,502) | \$ (958) |
| Transition obligation | (7)        | (14)     |
|                       | (1,509)    | (972)    |
| Tax effect            | 528        | 340      |
|                       | \$ (981)   | \$ (632) |

The accumulated benefit obligation was \$2,224 and \$1,674 at December 31, 2012 and 2011, respectively.

The following table sets forth the components of net periodic benefit cost and other amounts recognized in other comprehensive income:

|  | 2012  | 2011  | 2010  |
|--|-------|-------|-------|
| Service cost   | \$ 88 | \$ 49 | \$ 34 |
| Interest cost  | 69    | 56    | 43    |
| Net amortization of transition obligation and actuarial loss | 41    | 11    | 3     |
| Net periodic benefit cost                                    | 198   | 116   | 80    |
| Net loss   | 578   | 758   | 380   |
| Amortization of loss   | (34)  | (4)   | 4     |
| Amortization of transition obligation                        | (7)   | (7)   | (7)   |
| Total recognized in other comprehensive income               | 537   | 747   | 377   |

|  |        |        |        |
|--|--------|--------|--------|
| Total recognized in net periodic benefit cost and other comprehensive income | \$ 735 | \$ 863 | \$ 457 |
|--|--------|--------|--------|

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The estimated net loss and transition obligation that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are \$54 and \$7, respectively.

The weighted average discount rate used to calculate net periodic benefit cost was 4.29% in 2012, 5.50% in 2011, and 5.75% in 2010. The weighted average rate used to calculate accrued benefit obligations was 3.88% in 2012, 4.29% in 2011, and 5.50% in 2010. The health care cost trend rate used to measure the expected costs of benefits is 5.0% for 2013 and thereafter. A one percent increase in the health care trend rates would result in an increase of \$289 in the benefit obligation as of December 31, 2012, and would increase the service and interest costs by \$43 in future periods. A similar one percent decrease in health care trend rates would result in a decrease of \$247 and \$34 in the benefit obligation and services and interest costs, respectively, at December 31, 2012.

**14. Deferred Compensation Plans**

Deferred compensation plans cover all directors and certain officers. Under the plans, the Corporation pays each participant, or their beneficiary, the amount of fees or compensation deferred plus gains or net of losses over a maximum period of 10 years, beginning with the individual's termination of service. A liability is accrued for the obligation under these plans.

A summary of changes in the deferred compensation plan liability follows:

|  | 2012   | 2011     | 2010     |
|--|--------|----------|----------|
| Balance, beginning of year   | \$ 987 | \$ 1,038 | \$ 1,200 |
| Deferrals, dividends, and changes in fair value recorded as an expense | 84     | 80       | 41       |
| Deferred compensation payments   | (81)   | (131)    | (203)    |
| Balance, end of year   | \$ 990 | \$ 987   | \$ 1,038 |

**15. Stock-Based Compensation****Stock Options**

A summary of the status of the stock options is presented below:

|   | Stock Options | Weighted-average Exercise Price |
|---|---------------|---------------------------------|
| Outstanding at January 1, 2012                      | 107,375       | \$ 15.75                        |
| Exercised   | (31,875)      | 13.30                           |
| Outstanding at December 31, 2012                    | 75,500        | \$ 16.79                        |
| Options vested and exercisable at December 31, 2012 | 75,500        |                                 |
| Fair value of options granted during 2012           | -             |                                 |

Number of authorized  
stock-based awards available for  
grant

424,941

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Options outstanding and exercisable at December 31, 2012 are as follows:

| Exercise Price | Number | Remaining Contractual Life |
|----------------|--------|----------------------------|
| \$17.54        | 37,500 | 1.0 years                  |
| 16.04          | 38,000 | 2.0 years                  |
|                | 75,500 |                            |

The aggregate intrinsic value of all options outstanding and exercisable at December 31, 2012 and 2011 was \$13 and \$79, respectively.

Additional information related to the stock option plan follows:

|                                      | 2012   | 2011  | 2010  |
|--------------------------------------|--------|-------|-------|
| Intrinsic value of options exercised | \$ 114 | \$151 | \$ 42 |
| Cash received from option exercises  | 424    | 259   | 69    |

As of December 31, 2012, there was no unrecognized compensation cost related to nonvested stock options granted under the stock option plan.

**Restricted Stock Awards**

A summary of changes in nonvested restricted stock awards follows:

|                                | Shares   | Weighted-average Grant Date Fair Value |
|--------------------------------|----------|--|
| Nonvested at January 1, 2012   | 35,613   | \$15.08                                |
| Granted                        | 26,900   | 15.57                                  |
| Vested                         | (12,939) | 14.96                                  |
| Nonvested at December 31, 2012 | 49,574   | \$15.37                                |

As of December 31, 2012 and 2011, there was \$536 and \$394, respectively, of total unrecognized compensation cost related to nonvested shares granted under the restricted stock award plan. The fair value of shares vesting during 2012, 2011, and 2010 was \$206, \$173 and \$210, respectively. Compensation expense for restricted stock awards was \$277 in 2012, \$213 in 2011, and \$205 in 2010.

**16. Related Party Transactions**

In the ordinary course of business, the Bank has transactions, including loans, with its officers, directors, and their affiliated companies. The aggregate of such loans totaled \$1,144 on December 31, 2012 compared to \$1,509 at December 31, 2011. During 2012, \$506 new loans were made and repayments totaled \$871.

Deposits from principal officers, directors, and their affiliates were \$25,293 and \$15,164 at December 31, 2012 and 2011, respectively.



**Table of Contents****17. Capital Requirements and Restrictions on Retained Earnings**

Banks and financial holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, for the Bank, prompt corrective action (PCA) regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can result in regulatory enforcement actions. Management believes as of December 31, 2012 the Corporation and Bank meet all capital adequacy requirements to which they are subject.

The PCA regulations provide five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms alone do not represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion; brokered deposits may not be accepted, renewed or rolled over; and capital restoration plans are required. As of December 31, 2012 and 2011, the most recent regulatory notifications categorized the Bank as well capitalized under the PCA regulatory framework. There are no events or conditions since this notification that management believes have changed the Bank's capital category.

Actual and required capital amounts and ratios are presented below as of December 31, 2012 and 2011:

|   | Actual    |        | For Capital Adequacy Purposes |       | To Be Well Capitalized Under Prompt Corrective Action Provisions |       |
|---|-----------|--------|-------------------------------|-------|--|-------|
|   | Amount    | Ratio  | Amount                        | Ratio | Amount   | Ratio |
| <b>December 31, 2012</b>                      |           |        |                               |       |  |       |
| Total Capital to Risk Weighted Assets         |           |        |                               |       |  |       |
| Consolidated                                  | \$152,968 | 15.28% | \$80,073                      | 8.0%  | N/A  |       |
| Bank  | \$131,788 | 13.46% | \$78,324                      | 8.0%  | \$97,905   | 10.0% |
| Tier 1 (Core) Capital to Risk Weighted Assets |           |        |                               |       |  |       |
| Consolidated                                  | \$140,426 | 14.03% | \$40,036                      | 4.0%  | N/A  |       |
| Bank  | \$119,534 | 12.21% | \$39,162                      | 4.0%  | \$58,743   | 6.0%  |
| Tier 1 (Core) Capital to Average Assets       |           |        |                               |       |  |       |
| Consolidated                                  | \$140,426 | 8.06%  | \$69,726                      | 4.0%  | N/A  |       |
| Bank  | \$119,534 | 6.99%  | \$68,409                      | 4.0%  | \$85,512   | 5.0%  |
| <b>December 31, 2011</b>                      |           |        |                               |       |  |       |
| Total Capital to Risk Weighted Assets         |           |        |                               |       |  |       |
| Consolidated                                  | \$141,310 | 15.14% | \$74,647                      | 8.0%  | N/A  |       |
| Bank  | \$121,673 | 13.32% | \$73,101                      | 8.0%  | \$91,376   | 10.0% |
| Tier 1 (Core) Capital to Risk Weighted Assets |           |        |                               |       |  |       |
| Consolidated                                  | \$129,620 | 13.89% | \$37,323                      | 4.0%  | N/A  |       |
| Bank  | \$110,232 | 12.06% | \$36,550                      | 4.0%  | \$54,826   | 6.0%  |
| Tier 1 (Core) Capital to Average Assets       |           |        |                               |       |  |       |
| Consolidated                                  | \$129,620 | 8.22%  | \$63,083                      | 4.0%  | N/A  |       |
| Bank  | \$110,232 | 7.15%  | \$61,684                      | 4.0%  | \$77,106   | 5.0%  |

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Certain restrictions exist regarding the ability of the Bank to transfer funds to the Corporation in the form of cash dividends, loans or advances. At December 31, 2012, \$15,845 of accumulated net earnings of the Bank, included in the consolidated stockholders' equity, was available for distribution to the Corporation as dividends without prior regulatory approval, subject to regulatory capital requirements above.

**18. Off Balance Sheet Activities**

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off balance sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

The contractual amount of financial instruments with off balance sheet risk was as follows at December 31, 2012 and 2011:

|                           | 2012       |               | 2011       |               |
|---------------------------|------------|---------------|------------|---------------|
|                           | Fixed Rate | Variable Rate | Fixed Rate | Variable Rate |
| Commitments to make loans | \$13,670   | \$171,862     | \$12,467   | \$157,546     |
| Unused lines of credit    | -          | 69,621        | -          | 63,230        |
| Standby letters of credit | -          | 22,598        | -          | 21,923        |

Commitments to make loans are generally made for periods of 60 days or less. The fixed rate loan commitments at December 31, 2012 have interest rates ranging from 2.15% to 16.00% and maturities ranging from 3 months to 20 years. The fixed rate loan commitments at December 31, 2011 have interest rates ranging from 2.30% to 16.00% and maturities ranging from 3 months to 20 years.

**19. Fair Value****Fair Value Measurement**

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A fair value hierarchy has also been established which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following three levels of inputs are used to measure fair value:

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

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

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



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The fair values of most trading securities and securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). The fair value of one corporate bond held by the Corporation has been determined by using Level 3 inputs. The Corporation has engaged a valuation expert to price this security using a proprietary model, which incorporates assumptions about certain factors that market participants would use in pricing the securities, including bid/ask spreads and liquidity and credit premiums.

Trust preferred securities which are issued by financial institutions and insurance companies are priced using Level 3 inputs. The decline in the level of observable inputs and market activity in this class of investments by the measurement date has been significant and resulted in unreliable external pricing. Broker pricing and bid/ask spreads, when available, vary widely, and the once-active market has become comparatively inactive. The Corporation engaged a third party consultant who has developed a model for pricing these securities. Information such as historical and current performance of the underlying collateral, deferral and default rates, collateral coverage ratios, break in yield calculations, cash flow projections, liquidity and credit premiums required by a market participant, and financial trend analysis with respect to the individual issuing financial institutions and insurance companies are utilized in determining individual security valuations. Due to the current market conditions as well as the limited trading activity of these securities, the market value of the securities is highly sensitive to assumption changes and market volatility.

The Corporation's derivative instruments are interest rate swaps that are similar to those that trade in liquid markets. As such, significant fair value inputs can generally be verified and do not typically involve significant management judgments (Level 2 inputs).

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals prepared by third-parties. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Management also adjusts appraised values based on the length of time that has passed since the appraisal date and other factors. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

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Assets and liabilities measured at fair value on a recurring basis are as follows at December 31, 2012 and 2011:

| Description                                | Total             | Fair Value Measurements at December 31, 2012 Using                         |   |  |
|--|-------------------|--|---|--|
|  |                   | Quoted Prices in<br>Active Markets for<br>Identical<br>Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Assets:</b>                             |                   |  |   |  |
| <b>Securities Available For Sale:</b>      |                   |  |   |  |
| U.S. Treasury                              | \$ 4,036          | \$ -   | \$ 4,036  | \$ -   |
| U.S. Government sponsored entities         | 163,781           | -  | 163,781   | -  |
| States and political subdivisions          | 181,279           | -  | 181,279   | -  |
| Residential and multi-family mortgage      | 316,822           | -  | 316,822   | -  |
| Commercial mortgage                        | 1,304             | -  | 1,304   | -  |
| Corporate notes and bonds                  | 15,024            | -  | 13,044  | 1,980  |
| Pooled trust preferred                     | 600               | -  | -   | 600  |
| Pooled SBA                                 | 52,927            | 52,631   | 296   | -  |
| Other securities                           | 1,538             | 1,538  | -   | -  |
| <b>Total Securities Available For Sale</b> | <b>\$ 737,311</b> | <b>\$ 54,169</b>   | <b>\$ 680,562</b>                                   | <b>\$ 2,580</b>                                    |
| <b>Trading Securities:</b>                 |                   |  |   |  |
| Corporate equity securities                | \$ 3,117          | \$ 3,117   | \$ -  | \$ -   |
| Certificates of deposit                    | 408               | 408  | -   | -  |
| International mutual funds                 | 287               | 287  | -   | -  |
| Large cap growth mutual funds              | 157               | 157  | -   | -  |
| Money market mutual funds                  | 110               | 110  | -   | -  |
| Large cap value mutual funds               | 104               | 104  | -   | -  |
| Corporate notes and bonds                  | 101               | -  | 101   | -  |
| Real estate investment trust mutual funds  | 65                | 65   | -   | -  |
| U.S. Government sponsored entities         | 58                | -  | 58  | -  |
| Small cap mutual funds                     | 26                | 26   | -   | -  |
| Mid cap mutual funds                       | 26                | 26   | -   | -  |
| <b>Total Trading Securities</b>            | <b>\$ 4,459</b>   | <b>\$ 4,300</b>  | <b>\$ 159</b>                                       | <b>\$ -</b>  |
| <b>Liabilities,</b>                        |                   |  |   |  |
| Interest rate swaps                        | \$ (1,745)        | \$ -   | \$ (1,745)  | \$ -   |

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Fair Value Measurements at December 31, 2011 Using  
Quoted Prices in  
Active

| Description                                | Total             | Markets for                         |  |  |
|--|-------------------|-------------------------------------|--|--|
|  |                   | Identical<br>Assets<br>(Level<br>1) | Significant Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Assets:</b>                             |                   |                                     |  |  |
| <b>Securities Available For Sale:</b>      |                   |                                     |  |  |
| U.S. Treasury                              | \$ 8,130          | \$ -                                | \$ 8,130   | \$ -   |
| U.S. Government sponsored entities         | 107,492           | 2,000                               | 105,492  | -  |
| States and political subdivisions          | 158,437           | 4,655                               | 153,782  | -  |
| Residential and multi-family mortgage      | 300,126           | 8,577                               | 291,549  | -  |
| Commercial mortgage                        | 2,122             | -                                   | 2,122  | -  |
| Corporate notes and bonds                  | 13,860            | -                                   | 11,800   | 2,060  |
| Pooled trust preferred                     | 340               | -                                   | -  | 340  |
| Pooled SBA                                 | 46,056            | 46,056                              | -  | -  |
| Other securities                           | 1,544             | 1,544                               | -  | -  |
| <b>Total Securities Available For Sale</b> | <b>\$ 638,107</b> | <b>\$ 62,832</b>                    | <b>\$ 572,875</b>                                      | <b>\$ 2,400</b>                                    |
| <b>Trading Securities:</b>                 |                   |                                     |  |  |
| Corporate equity securities                | \$ 1,959          | \$ 1,959                            | \$ -   | \$ -   |
| Certificates of deposit                    | 255               | 255                                 | -  | -  |
| International mutual funds                 | 257               | 257                                 | -  | -  |
| Large cap growth mutual funds              | 145               | 145                                 | -  | -  |
| Money market mutual funds                  | 241               | 241                                 | -  | -  |
| Large cap value mutual funds               | 105               | 105                                 | -  | -  |
| Corporate notes and bonds                  | 100               | -                                   | 100  | -  |
| Real estate investment trust mutual funds  | 68                | 68                                  | -  | -  |
| U.S. Government sponsored entities         | 55                | -                                   | 55   | -  |
| Small cap mutual funds                     | 25                | 25                                  | -  | -  |
| Mid cap mutual funds                       | 23                | 23                                  | -  | -  |
| <b>Total Trading Securities</b>            | <b>\$ 3,233</b>   | <b>\$ 3,078</b>                     | <b>\$ 155</b>  | <b>\$ -</b>  |
| <b>Liabilities,</b>                        |                   |                                     |  |  |
| Interest rate swaps                        | \$ (1,669)        | \$ -                                | \$ (1,669)   | \$ -   |

The table below presents a reconciliation and income statement classification of gains and losses for all securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31, 2012:

|   | Corporate<br>notes and<br>bonds | Pooled<br>trust<br>preferred |
|---|---------------------------------|------------------------------|
| Balance, January 1, 2012                            | \$ 2,060                        | \$ 340                       |
| Total gains or (losses):                            |                                 |                              |
| Included in other comprehensive income (unrealized) | (80)                            | 260                          |
| Balance, December 31, 2012                          | \$ 1,980                        | \$ 600                       |



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The table below presents a reconciliation and income statement classification of gains and losses for all securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2011:

|   | Residential<br>mortgage and<br>asset<br>backed | Corporate<br>notes and<br>bonds | U.S. Gov t<br>Sponsored<br>Entities | Pooled<br>trust<br>preferred |
|---|--|---------------------------------|-------------------------------------|------------------------------|
| Balance, January 1, 2011                      | \$ 2,269                                       | \$ 1,240                        | \$ 2,000                            | \$ 1,292                     |
| Transfers out of Level 3 (a)(b)               | (3,988)  | -                               | (2,000)                             | -                            |
| Total gains or losses (realized/unrealized):  |  |                                 |                                     |                              |
| Included in earnings                          | -  | -                               | -                                   | (398)                        |
| Included in other comprehensive income        | -  | 820                             | -                                   | 438                          |
| Purchases, issuances, sales, and settlements: |  |                                 |                                     |                              |
| Purchases                                     | 1,917  | -                               | -                                   | -                            |
| Settlements                                   | (198)  | -                               | -                                   | (992)                        |
| Balance, December 31, 2011                    | \$ -   | \$ 2,060                        | \$ -                                | \$ 340                       |

(a) Transferred from Level 3 to Level 2 since observable market data became available to value the security.

(b) The Corporation's policy is to recognize transfers in and transfers out as of the beginning of the reporting period.

The unrealized losses reported in earnings for the year ended December 31, 2011 for Level 3 assets that are still held at the balance sheet date relate to one structured pooled trust preferred security deemed to be other-than-temporarily impaired.

The following table presents quantitative information about Level 3 fair value measurements at December 31, 2012:

|                           | Fair value | Valuation<br>Technique  | Unobservable<br>Inputs   | Input<br>Utilized        |
|---------------------------|------------|-------------------------|--------------------------|--------------------------|
| Corporate notes and bonds | \$ 1,980   | Discounted<br>cash flow | Constant prepayment rate | -%                       |
|                           |            |                         | Probability of default   | -%                       |
|                           |            |                         | Discount rate            | 9.6%                     |
| Pooled trust preferred    | \$ 600     | Discounted<br>cash flow | Collateral default rate  | 2% annually for 2 years; |
|                           |            |                         |                          | 0.36% thereafter         |
|                           |            |                         | Discount rate            | 13%                      |
|                           |            |                         | Recovery probability     | 10%, lagged 2 years      |

The significant unobservable inputs used in the fair value measurement of the Corporation's corporate notes and bonds are prepayment rates, probability of default, and discount rate. Significant changes in any of those inputs in isolation would result in a significantly different fair value measurement. The significant unobservable inputs used in the fair value measurement of the Corporation's pooled trust preferred securities are collateral default rate, discount rate, and recovery probability. Prepayment rates are also estimated for pooled trust preferred securities and vary depending on the asset size of the company that issued the security and whether the issue is fixed rate or variable rate; however, the overall effect of prepayment rates on fair value is not material. Significant increases in specific-issuer default assumptions or decreases in specific-issuer recovery assumptions would result in a significantly lower fair value measurement. Conversely, decreases in specific-issuer default assumptions

or increases in specific-issuer recovery assumptions would result in a higher fair value measurement.

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During the year ended December 31, 2012 and 2011, the following available for sale securities reported as Level 1 securities as of the beginning of the year were transferred to the Level 2 category:

|                                       | 2012      | 2011      |
|---------------------------------------|-----------|-----------|
| U.S. Government sponsored entities    | \$ 2,000  | \$ 2,000  |
| States and political subdivisions     | 4,655     | 4,750     |
| Residential and multi-family mortgage | 8,577     | 20,405    |
| Total                                 | \$ 15,232 | \$ 27,155 |

These securities were transferred from the Level 1 category to the Level 2 category since there were no longer quoted prices for identical assets in active markets that the Corporation had the ability to access. The Corporation's policy is to recognize transfers as of the beginning of the reporting period.

During the year ended December 31, 2011, two pooled SBA securities that were classified as Level 2 securities at December 31, 2010 were transferred to the Level 1 category. The fair value on the date of transfer was \$3,437. These securities were transferred since the Corporation was able to access a quoted price for identical assets in an active market. There were no transfers of securities from the Level 2 category to the Level 1 category during the year ended December 31, 2012.

Assets and liabilities measured at fair value on a non-recurring basis are as follows at December 31, 2012 and 2011:

| Description                              | Total    | Fair Value Measurements at December 31, 2012<br>Using                         |  |  |
|--|----------|---|--|--|
|  |          | Quoted Prices in<br>Active Markets for<br>Identical<br>Assets<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level<br>2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Assets:</b>                           |          |   |  |  |
| <b>Impaired loans:</b>                   |          |   |  |  |
| Commercial mortgages                     | \$ 8,422 | \$ -  | \$ -   | \$ 8,422   |
| Commercial, industrial, and agricultural | 1,973    | -   | -  | 1,973  |
| Residential real estate                  | 402      | -   | -  | 402  |

| Description                              | Total    | Fair Value Measurements at December 31, 2011<br>Using                                     |  |  |
|--|----------|---|--|--|
|  |          | Quoted<br>Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level<br>2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Assets:</b>                           |          |   |  |  |
| <b>Impaired loans:</b>                   |          |   |  |  |
| Commercial mortgages                     | \$ 7,219 | \$ -  | \$ -   | \$ 7,219   |
| Commercial, industrial, and agricultural | 3,190    | -   | -  | 3,190  |

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|                         |     |   |   |     |
|-------------------------|-----|---|---|-----|
| Residential real estate | 105 | - | - | 105 |
|-------------------------|-----|---|---|-----|

Impaired loans, which are measured for impairment using the fair value of collateral for collateral dependent loans, had a principal balance of \$12,535, with a valuation allowance of \$1,738 as of December 31, 2012, resulting in an additional provision for loan losses of \$2,558 for the year then ended. Impaired loans had a principal balance of \$22,384, with a valuation allowance of \$1,493 as of December 31, 2011, resulting in an additional provision for loan losses of \$583 for the year then ended.



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The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2012:

|                |  | Fair value | Valuation                 | Unobservable  | Range              |
|----------------|--|------------|---------------------------|---|--------------------|
|                |  |            | Technique                 | Inputs  | (Weighted Average) |
| Impaired loans | commercial mortgages                     | \$ 8,422   | Sales comparison approach | Adjustment for differences between the comparable sales | 1% 39%(19%)        |
| Impaired loans | commercial, industrial, and agricultural | 1,973      | Income approach           | Adjusting for differences in net operating income       | 24% 38%(27%)       |
| Impaired loans | residential real estate                  | 402        | Sales comparison approach | Adjustment for differences between the comparable sales | 10% 15%(11%)       |

**Fair Value of Financial Instruments**

The following table presents the carrying amount and fair value of financial instruments at December 31, 2012:

|   | Carrying Amount | Fair Value Measurement Using: |              |         | Total Fair Value |
|---|-----------------|-------------------------------|--------------|---------|------------------|
|   |                 | Level 1                       | Level 2      | Level 3 |                  |
| <b>ASSETS</b>                                   |                 |                               |              |         |                  |
| Cash and cash equivalents                       | \$ 31,881       | \$ 31,881                     | \$ -         | \$ -    | \$ 31,881        |
| Interest bearing time deposits with other banks | 225             | -                             | 281          | -       | 281              |
| Securities available for sale                   | 737,311         | 54,169                        | 680,562      | 2,580   | 737,311          |
| Trading securities                              | 4,459           | 4,300                         | 159          | -       | 4,459            |
| Loans held for sale                             | 2,398           | -                             | 2,460        | -       | 2,460            |
| Net loans                                       | 913,764         | -                             | -            | 946,238 | 946,238          |
| FHLB and other equity interests                 | 6,684           | n/a                           | n/a          | n/a     | n/a              |
| Accrued interest receivable                     | 6,863           | 278                           | 3,498        | 3,087   | 6,863            |
| <b>LIABILITIES</b>                              |                 |                               |              |         |                  |
| Deposits  | \$ (1,485,003)  | \$ (1,272,060)                | \$ (215,485) | \$ -    | \$ (1,487,545)   |
| FHLB and other borrowings                       | (97,806)        | -                             | (105,850)    | -       | (105,850)        |
| Subordinated debentures                         | (20,620)        | -                             | (10,682)     | -       | (10,682)         |
| Interest rate swaps                             | (1,745)         | -                             | (1,745)      | -       | (1,745)          |
| Accrued interest payable                        | (1,022)         | (301)                         | (707)        | (14)    | (1,022)          |

The following table presents the carrying amount and fair value of financial instruments at December 31, 2011:

|   | Carrying Amount | Fair Value     |
|---|-----------------|----------------|
| <b>ASSETS</b>                                   |                 |                |
| Cash and cash equivalents                       | \$ 39,703       | \$ 39,703      |
| Interest bearing time deposits with other banks | 224             | 229            |
| Securities available for sale                   | 638,107         | 638,107        |
| Trading securities                              | 3,233           | 3,233          |
| Loans held for sale                             | 1,442           | 1,470          |
| Net loans                                       | 837,268         | 862,389        |
| FHLB and other equity interests                 | 6,537           | N/A            |
| Accrued interest receivable                     | 6,567           | 6,567          |
| <b>LIABILITIES</b>                              |                 |                |
| Deposits  | \$ (1,353,851)  | \$ (1,357,415) |
| FHLB and other borrowings                       | (74,456)        | (83,042)       |

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|                          |          |          |
|--------------------------|----------|----------|
| Subordinated debentures  | (20,620) | (10,906) |
| Interest rate swaps      | (1,669)  | (1,669)  |
| Accrued interest payable | (1,308)  | (1,308)  |

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The methods and assumptions, not otherwise presented, used to estimate fair values are described as follows:

**Cash and cash equivalents:** The carrying amounts of cash and cash equivalents approximate fair values and are classified as Level 1.

**Interest bearing time deposits with other banks:** The fair value of interest bearing time deposits with other banks is estimated using a discounted cash flow calculation that applies interest rates currently being offered to a schedule of aggregated expected monthly maturities, resulting in a Level 2 classification.

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

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

**FHLB and other equity interests:** It is not practical to determine the fair value of Federal Home Loan Bank stock and other equity interests due to restrictions placed on the transferability of these instruments.

**Accrued interest receivable:** The carrying amount of accrued interest receivable approximates fair value resulting in a classification that is consistent with the asset with which it is associated.

**Deposits:** The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amount), resulting in a Level 1 classification. Fair values for time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits, resulting in a Level 2 classification.

**FHLB and other borrowings:** The fair values of the Corporation's FHLB and other borrowings are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements, resulting in a Level 2 classification.

**Subordinated debentures:** The fair value of the Corporation's subordinated debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of arrangements, resulting in a Level 3 classification.

**Accrued interest payable:** The carrying amount of accrued interest payable approximates fair value resulting in a classification that is consistent with the liability with which it is associated.

While estimates of fair value are based on management's judgment of the most appropriate factors as of the balance sheet date, there is no assurance that the estimated fair values would have been realized if the assets had been disposed of or the liabilities settled at that date, since market values may differ depending on various circumstances. The estimated fair values would also not apply to subsequent dates.

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In addition, other assets and liabilities that are not financial instruments, such as premises and equipment, are not included in the disclosures. Also, non-financial assets such as, among other things, the estimated earnings power of core deposits, the earnings potential of trust accounts, the trained workforce, and customer goodwill, which typically are not recognized on the balance sheet, may have value but are not included in the fair value disclosures.

**20. Parent Company Only Financial Information (Dollars in thousands)****CONDENSED BALANCE SHEETS**

|   | December 31,      |                   |
|---|-------------------|-------------------|
|   | 2012              | 2011              |
| <b>Assets</b>                                     |                   |                   |
| Cash  | \$ 2,029          | \$ 1,936          |
| Trading securities                                | 229               | 175               |
| Investment in bank subsidiary                     | 138,195           | 126,242           |
| Investment in non-bank subsidiaries               | 27,796            | 26,579            |
| Deferred tax asset                                | 883               | 839               |
| Other assets                                      | 2,249             | 2,313             |
| <b>Total assets</b>                               | <b>\$ 171,381</b> | <b>\$ 158,084</b> |
| <b>Liabilities</b>                                |                   |                   |
| Borrowings from subsidiary                        | \$ 1,950          | \$ 2,150          |
| Subordinated debentures                           | 20,620            | 20,620            |
| Other liabilities                                 | 3,447             | 3,425             |
| <b>Total liabilities</b>                          | <b>26,017</b>     | <b>26,195</b>     |
| Total shareholders' equity                        | 145,364           | 131,889           |
| <b>Total liabilities and shareholders' equity</b> | <b>\$ 171,381</b> | <b>\$ 158,084</b> |

**CONDENSED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**

|  | Year Ended December 31, |                |                |
|--|-------------------------|----------------|----------------|
|  | 2012                    | 2011           | 2010           |
| <b>Income</b>  |                         |                |                |
| <b>Dividends from:</b>   |                         |                |                |
| Bank subsidiary  | \$ 7,990                | \$ 7,600       | \$ 6,665       |
| Non-bank subsidiaries  | -                       | -              | 150            |
| Other  | 208                     | 146            | 165            |
| <b>Total income</b>  | <b>8,198</b>            | <b>7,746</b>   | <b>6,980</b>   |
| <b>Expenses</b>  | <b>(1,457)</b>          | <b>(1,410)</b> | <b>(1,383)</b> |
| <b>Income before income taxes and equity in undistributed net income of subsidiaries</b> | <b>6,741</b>            | <b>6,336</b>   | <b>5,597</b>   |
| Income tax benefit   | 438                     | 443            | 426            |
| Equity in undistributed net income of bank subsidiary                                    | 8,682                   | 7,162          | 4,463          |
| Equity in undistributed net income of non-bank subsidiaries                              | 1,275                   | 1,163          | 830            |
| <b>Net income</b>  | <b>17,136</b>           | <b>15,104</b>  | <b>11,316</b>  |

Other Comprehensive Income:

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|   |           |           |           |
|---|-----------|-----------|-----------|
| Net change in unrealized gains/losses on available for sale securities, net of reclassification and tax | 3,561     | 14,441    | 2,554     |
| Change in actuarial gain, net of amortization and tax, for post-employment health care plan, net of tax | (349)     | (485)     | (245)     |
| Change in fair value of interest rate swap agreements designated as a cash flow hedge, net of tax       | (49)      | (522)     | (107)     |
| Total other comprehensive income  | 3,163     | 13,434    | 2,202     |
| Comprehensive income  | \$ 20,299 | \$ 28,538 | \$ 13,518 |

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| CONDENSED STATEMENTS OF CASH FLOWS  | Year Ended December 31, |                 |                 |
|---|-------------------------|-----------------|-----------------|
|   | 2012                    | 2011            | 2010            |
| Net income  |                         |                 |                 |
| Adjustments to reconcile net income to net cash provided by operating activities: | \$ 17,136               | \$ 15,104       | \$ 11,316       |
| Equity in undistributed net income of bank subsidiary                             | (8,682)                 | (7,162)         | (4,463)         |
| Equity in undistributed (net income) loss of non-bank subsidiaries                | (1,275)                 | (1,163)         | (830)           |
| Net unrealized (gains) losses on securities for which fair value was elected      | (54)                    | 2               | (12)            |
| Decrease (increase) in other assets   | 47                      | 39              | (172)           |
| Increase in other liabilities   | 384                     | 334             | 202             |
| <b>Net cash provided by operating activities</b>                                  | <b>7,556</b>            | <b>7,154</b>    | <b>6,041</b>    |
| Cash flows from investing activities:   |                         |                 |                 |
| Capital transfer to subsidiaries  | -                       | -               | (29,130)        |
| Purchase of securities  | -                       | (100)           | -               |
| <b>Net cash used in investing activities</b>                                      | <b>-</b>                | <b>(100)</b>    | <b>(29,130)</b> |
| Cash flows from financing activities:   |                         |                 |                 |
| Dividends paid  | (8,214)                 | (8,125)         | (6,933)         |
| Proceeds from sale of treasury stock and option exercises, including tax benefit  | 951                     | 1,447           | 1,269           |
| Proceeds from stock offering, net of issuance costs                               | -                       | -               | 32,128          |
| Repayment of long-term borrowing  | -                       | -               | (3,500)         |
| Net advance to (repayment from) subsidiary  | (200)                   | 400             | 250             |
| <b>Net cash provided by (used in) financing activities</b>                        | <b>(7,463)</b>          | <b>(6,278)</b>  | <b>23,214</b>   |
| <b>Net increase in cash</b>   | <b>93</b>               | <b>776</b>      | <b>125</b>      |
| Cash beginning of year  | 1,936                   | 1,160           | 1,035           |
| <b>Cash end of year</b>   | <b>\$ 2,029</b>         | <b>\$ 1,936</b> | <b>\$ 1,160</b> |

**Table of Contents****21. Other Comprehensive Income**

Other comprehensive income components and related tax effects were as follows for the years ended December 31, 2012, 2011, and 2010:

|  | 2012     | 2011      | 2010     |
|--|----------|-----------|----------|
| Unrealized holding gains on available for sale securities  | \$ 6,597 | \$ 22,457 | \$ 3,815 |
| Less reclassification adjustment for gains recognized in earnings  | (1,379)  | (614)     | (1,660)  |
| Net unrealized gains   | 5,218    | 21,843    | 2,155    |
| Tax effect   | (1,826)  | (7,642)   | (755)    |
| Net-of-tax amount  | 3,392    | 14,201    | 1,400    |
| Unrealized holding gains (losses) on available for sale securities for which a portion of an other-than-temporary impairment has been recognized in earnings | 260      | (28)      | (466)    |
| Less reclassification adjustment for impairment loss recognized in earnings  | -        | 398       | 2,241    |
| Net unrealized gains   | 260      | 370       | 1,775    |
| Tax effect   | (91)     | (130)     | (621)    |
| Net-of-tax amount  | 169      | 240       | 1,154    |
| Actuarial loss on postemployment health care plan  | (578)    | (757)     | (380)    |
| Net amortization of transition obligation and actuarial gain   | 41       | 11        | 3        |
| Net unrealized loss on postemployment health care plan   | (537)    | (746)     | (377)    |
| Tax effect   | 188      | 261       | 132      |
| Net-of-tax amount  | (349)    | (485)     | (245)    |
| Unrealized loss on interest rate swap  | (465)    | (1,205)   | (566)    |
| Less reclassification adjustment for losses recognized in earnings   | 390      | 402       | 401      |
| Net unrealized gain (loss)   | (75)     | (803)     | (165)    |
| Tax effect   | 26       | 281       | 58       |
| Net-of-tax amount  | (49)     | (522)     | (107)    |
| Other comprehensive income   | \$ 3,163 | \$ 13,434 | \$ 2,202 |

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The following is a summary of the change in the accumulated other comprehensive income (loss) balance, net of tax, for the years ended December 31, 2012, 2011, and 2010:

|  | Balance<br>1/1/10 | Increase<br>(Decrease) | Balance<br>12/31/10 | Increase<br>(Decrease) | Balance<br>12/31/11 | Increase<br>(Decrease) | Balance<br>12/31/12 |
|--|-------------------|------------------------|---------------------|------------------------|---------------------|------------------------|---------------------|
| Unrealized gains (losses) on securities available for sale | \$ (4,517)        | \$ 2,554               | \$ (1,963)          | \$ 14,441              | \$ 12,478           | \$ 3,561               | \$ 16,039           |
| Unrealized gain (loss) on postretirement benefits plan     | 98                | (245)                  | (147)               | (485)                  | (632)               | (349)                  | (981)               |
| Unrealized loss on interest rate swap                      | (456)             | (107)                  | (563)               | (522)                  | (1,085)             | (49)                   | (1,134)             |
| Total  | \$ (4,875)        | \$ 2,202               | \$ (2,673)          | \$ 13,434              | \$ 10,761           | \$ 3,163               | \$ 13,924           |

**22. Quarterly Financial Data (Unaudited)**

The unaudited quarterly results of operations for the years ended December 31, 2012 and 2011 are as follows (in thousands, except per share data):

|                                    | Quarters Ended in 2012 |           |           |           | Quarters Ended in 2011 |           |           |           |
|------------------------------------|------------------------|-----------|-----------|-----------|------------------------|-----------|-----------|-----------|
|                                    | Mar. 31                | June 30   | Sept. 30  | Dec. 31   | Mar. 31                | June 30   | Sept. 30  | Dec. 31   |
| Total interest and dividend income | \$ 16,824              | \$ 17,207 | \$ 17,133 | \$ 16,965 | \$ 15,694              | \$ 16,417 | \$ 16,793 | \$ 16,808 |
| Net interest income                | 12,677                 | 13,274    | 13,670    | 13,588    | 11,299                 | 11,912    | 12,378    | 12,544    |
| Provision for loan losses          | 1,104                  | 1,746     | 1,188     | 2,343     | 777                    | 992       | 904       | 2,264     |
| Non-interest income                | 3,518                  | 3,264     | 3,079     | 2,803     | 2,187                  | 2,616     | 2,462     | 3,454     |
| Non-interest expense               | 9,014                  | 8,833     | 9,208     | 8,890     | 8,291                  | 8,141     | 8,310     | 8,540     |
| Net income                         | 4,347                  | 4,336     | 4,563     | 3,890     | 3,277                  | 3,891     | 4,067     | 3,869     |
| Net income per share, basic        | 0.35                   | 0.35      | 0.37      | 0.31      | 0.27                   | 0.32      | 0.33      | 0.31      |
| Net income per share, diluted      | 0.35                   | 0.35      | 0.37      | 0.31      | 0.27                   | 0.32      | 0.33      | 0.31      |

A provision for loan losses in the amount of \$2,343 and \$2,264 was recorded during the quarters ended December 31, 2012 and 2011, respectively, as a result of specific reserves required for impaired loans in the commercial, industrial, and agricultural loan portfolio in the fourth quarters of 2012 and 2011. The quarterly volatility in non-interest income primarily relates to net realized gains and losses on available-for-sale securities.



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**Report of Independent Registered Public Accounting Firm**

**Crowe Horwath LLP**

**Independent Member Crowe Horwath International**

Board of Directors and Shareholders

CNB Financial Corporation

Clearfield, Pennsylvania

We have audited the accompanying consolidated balance sheets of CNB Financial Corporation as of December 31, 2012 and 2011, and the related consolidated statements of income and comprehensive income, cash flows, and changes in shareholders' equity for each of the years in the three-year period ended December 31, 2012. We also have audited CNB Financial Corporation's internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). CNB Financial Corporation's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting located in Item 9A of Form 10-K. Our responsibility is to express an opinion on these financial statements and an opinion on the company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of CNB Financial Corporation as of December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, CNB Financial Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control – Integrated Framework issued by the COSO.

/s/ Crowe Horwath LLP

Crowe Horwath LLP

Cleveland, Ohio

March 8, 2013

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**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None

**ITEM 9A. CONTROLS AND PROCEDURES**

The Corporation's management, under the supervision of and with the participation of the Corporation's Principal Executive Officer and Principal Financial Officer, has carried out an evaluation of the design and effectiveness of the Corporation's disclosure controls and procedures as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Securities Exchange Act of 1934 as of the end of the period covered by this report. Based upon that evaluation, management, including the Principal Executive Officer and Principal Financial Officer, have concluded that, as of the end of such period, the Corporation's disclosure controls and procedures are effective to provide reasonable assurance that all material information required to be disclosed in reports the Corporation files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms.

There was no significant change in the Corporation's internal control over financial reporting that occurred during the quarter ended December 31, 2012 that has materially affected, or that is reasonably likely to materially affect, our internal control over financial reporting.

**Management's Report on Internal Control Over Financial Reporting**

The management of the Corporation is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. The Corporation's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the U.S.

The Corporation's internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Corporation; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Corporation are being made only in accordance with authorizations of management and directors of the Corporation; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Corporation's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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Management assessed the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2012. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on our assessment and those criteria, management concluded that the Corporation maintained effective internal control over financial reporting as of December 31, 2012. The effectiveness of our internal control over financial reporting as of December 31, 2012 has been audited by Crowe Horwath LLP, an independent registered public accounting firm that audited the Corporation's financial statements, as stated in their report which is located in Item 8 of this Form 10-K.

Joseph B. Bower, Jr.  
President and Chief Executive Officer

Brian W. Wingard  
Treasurer and Principal Financial Officer

Date: March 8, 2013

Date: March 8, 2013

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**ITEM 9B. OTHER INFORMATION**

None

**PART III.**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

See Part I Item 1 Executive Officers for information about our executive officers, which is incorporated by reference in this Item 10. Other information required by this Item 10 is incorporated herein by reference to our definitive proxy statement for our 2013 annual meeting of stockholders (the 2013 proxy statement), which we will file with the SEC on or before 120 days after our 2012 fiscal year-end, and which will appear in the 2013 proxy statement under the captions Proposal 1. Election of Class 1 Directors, Corporate Governance Meetings and Committees of the Board of Directors Audit Committee and Section 16(a) Beneficial Ownership Reporting Compliance.

The Corporation's board of directors has approved a Code of Ethics for Officers and Directors. The Code of Ethics can be found at the Bank's website, [www.bankcnb.com](http://www.bankcnb.com).

**ITEM 11. EXECUTIVE COMPENSATION**

Information required by this Item 11 is incorporated herein by reference to the 2013 proxy statement, including the information in the 2013 proxy statement appearing under the captions Executive Compensation and Compensation of Directors.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

Information required by this Item 12 is incorporated herein by reference to the 2013 proxy statement, including the information in the 2013 proxy statement appearing under the captions Stock Ownership and Equity Compensation Plan Information.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

Information required by this Item 13 is incorporated herein by reference to the 2013 proxy statement, including the information in the 2013 proxy statement appearing under the captions Corporate Governance and Certain Transactions.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

Information required by this Item 14 is incorporated herein by reference to the 2013 proxy statement, including the information in the 2013 proxy statement appearing under the captions Corporate Governance Meetings and Committees of the Board of Directors Audit Committee and Concerning the Independent Registered Public Accountants.

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**PART IV.**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a)(1) The following consolidated financial statements are set forth in Part II, Item 8:

Consolidated Balance Sheets as of December 31, 2012 and 2011

Consolidated Statements of Income and Comprehensive Income for the years ended December 31, 2012, 2011, and 2010

Consolidated Statements of Cash Flows for the years ended December 31, 2012, 2011 and 2010

Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2012, 2011, and 2010

Notes to Consolidated Financial Statements

(a)(2) Financial statement schedules are not applicable or are included in the consolidated financial statements or related notes.

(a)(3) The following exhibits (asterisk denotes management contract or compensatory plan) are filed as a part of this report:

| Exhibit |  |
|---------|--|
| No.     | Description  |
| 3.1     | Amended and Restated Articles of Incorporation of the Corporation, filed as Appendix B to the 2006 Proxy Statement, filed with the SEC on March 24, 2006, and incorporated herein by reference.            |
| 3.2     | By-Laws of the Corporation, as amended and restated, filed as Appendix C to the 2006 Proxy Statement, filed with the SEC on March 24, 2006, and incorporated herein by reference.                          |
| 10.1    | Employment contract with Joseph B. Bower, Jr., President and Chief Executive Officer, filed as Exhibit 10.1 to Form 8-K, filed with the SEC on March 9, 2012, and incorporated herein by reference.*       |
| 10.2    | 1999 Stock Incentive Plan, filed as Exhibit A to the 1999 Proxy Statement, filed with the SEC on March 29, 1999, and incorporated herein by reference.*  |
| 10.3    | Employment contract with Richard L. Sloppy, Executive Vice President/Chief Lending Officer, filed as Exhibit 10.3 to Form 8-K, filed with the SEC on March 9, 2012, and incorporated herein by reference.* |
| 10.4    | 2009 Stock Incentive Plan, filed as Exhibit 10(iii)-4 to Registration Statement No. 333-159941, filed with the SEC on November 12, 2009, and incorporated herein by reference.*                            |
| 10.5    | Employment contract with Mark D. Breakey, Executive Vice President/Chief Credit Officer, filed as Exhibit 10.4 to Form 8-K, filed with the SEC on March 9, 2012, and incorporated herein by reference.*    |

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| Exhibit |  |
|---------|--|
| No.     | Description  |
| 10.6    | Employment contract with Richard L. Greslick, Jr., Executive Vice President/Chief Operating Officer, filed as Exhibit 10.2 to Form 8-K, filed with the SEC on March 9, 2012, and incorporated herein by reference.*  |
| 21      | Subsidiaries of the Registrant, filed as Exhibit 21 to the 2006 Form 10-K, filed with the SEC on March 15, 2007, and incorporated herein by reference.   |
| 23.1    | Consent of Independent Registered Public Accounting Firm   |
| 31.1    | Rule 13a-14(a)/15d-14(a) Certification of the Principal Executive Officer  |
| 31.2    | Rule 13a-14(a)/15d-14(a) Certification of the Principal Financial Officer  |
| 32.1    | Section 1350 Certification   |
| 32.2    | Section 1350 Certification   |
| 99.1    | Additional information mailed to shareholders with proxy statement and Form 10-K   |
| 101     | The following financial information from the Corporation's Annual Report on Form 10-K for the year ended December 31, 2012, furnished electronically herewith, and formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Income and Comprehensive Income; (iii) Consolidated Statements of Cash Flows; and (iv) Consolidated Statements of Changes in Shareholders' Equity. |

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CNB FINANCIAL CORPORATION  
(Registrant)

Date: March 8, 2013

By: /s/ Joseph B. Bower, Jr.  
JOSEPH B. BOWER, JR.  
President & Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on March 8, 2013.

/s/ Joseph B. Bower, Jr.  
JOSEPH B. BOWER, JR.  
President and Director  
(Principal Executive Officer)

/s/ Dennis L. Merrey  
DENNIS L. MERREY, Chairman

/s/ Richard L. Greslick, Jr.  
RICHARD L. GRESLICK, JR.  
Secretary and Director

/s/ Jeffrey S. Powell  
JEFFREY S. POWELL, Director

/s/ Brian W. Wingard  
BRIAN W. WINGARD  
Treasurer  
(Principal Financial and Accounting Officer)

/s/ Charles H. Reams  
CHARLES H. REAMS, Director

/s/ William F. Falger  
WILLIAM F. FALGER, Director

/s/ James B. Ryan  
JAMES B. RYAN, Director

/s/ Robert W. Montler  
ROBERT W. MONTLER, Director

/s/ Richard B. Seager  
RICHARD B. SEAGER, Director

/s/ Deborah Dick Pontzer  
DEBORAH DICK PONTZER, Director

/s/ Peter F. Smith  
PETER F. SMITH, Director

/s/ Joel E. Peterson  
JOEL E. PETERSON, Director



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## EXHIBIT INDEX

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\* Denotes management contract or compensatory plan.

\*\* In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Annual Report on Form 10-K shall not be deemed to be filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.