PLUMAS BANCORP
Form 10-Q
May 10, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE QUARTERLY PERIOD ENDED March 31, 2013

¨ **TRANSITION REPORT UNDER SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE TRANSITION PERIOD FROM _________ TO _________

COMMISSION FILE NUMBER: 000-49883

PLUMAS BANCORP

(Exact Name of Registrant as Specified in Its Charter)

California	**75-2987096**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification No.)**
35 S. Lindan Avenue, Quincy, California	**95971**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s Telephone Number, Including Area Code (530) 283-7305

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

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

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

Large Accelerated Filer	¨	Accelerated Filer	¨
Non-Accelerated Filer	¨	Smaller Reporting Company	x

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of May 7, 2013. 4,776,339 shares

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PLUMAS BANCORP

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except share data)

	March 31, 2013	December 31, 2012
Assets		
Cash and cash equivalents	$ 47,762	$ 44,675
Investment securities available for sale	80,446	80,964
Loans, less allowance for loan losses of $5,777 at March 31, 2013 and $5,686 at December 31, 2012	308,436	310,271
Premises and equipment, net	13,010	13,271
Bank owned life insurance	11,251	11,160
Real estate and vehicles acquired through foreclosure	5,318	5,336
Accrued interest receivable and other assets	11,758	12,125
Total assets	$ 477,981	$ 477,802
Liabilities and Shareholders Equity		
Deposits:		
Non-interest bearing	$ 133,432	$ 143,646
Interest bearing	278,800	267,916
Total deposits	412,232	411,562
Repurchase agreements	7,401	7,377
Accrued interest payable and other liabilities	5,731	6,703
Junior subordinated deferrable interest debentures	10,310	10,310
Total liabilities	435,674	435,952
Commitments and contingencies (Note 6)		
Shareholders equity:		
Serial preferred stock, no par value; 10,000,000 shares authorized; 11,949 issued and outstanding at March 31, 2013 and December 31, 2012; aggregate liquidation value of $13,816 at March 31, 2013 and $13,667 at December 31, 2012.	11,877	11,855
Common stock, no par value; 22,500,000 shares authorized; issued and outstanding 4,776,339 shares at March 31, 2013 and December 31, 2012	6,102	6,093
Retained earnings	24,167	23,573
Accumulated other comprehensive income	161	329
Total shareholders equity	42,307	41,850
Total liabilities and shareholders equity	$ 477,981	$ 477,802

See notes to unaudited condensed consolidated financial statements.

PLUMAS BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands, except per share data)

	For the Three Months Ended March 31, 2013	2012
Interest Income:		
Interest and fees on loans	$ 4,316	$ 4,228
Interest on investment securities	256	185
Other	22	33
Total interest income	4,594	4,446
Interest Expense:		
Interest on deposits	155	240
Interest on junior subordinated deferrable interest debentures	83	78
Other	27	20
Total interest expense	265	338
Net interest income before provision for loan losses	4,329	4,108
Provision for Loan Losses	700	600
Net interest income after provision for loan losses	3,629	3,508
Non-Interest Income:		
Service charges	876	872
Gain on sale of loans	521	234
Earnings on Bank owned life insurance	91	85
Gain on sale of investments		51
Other	212	185
Total non-interest income	1,700	1,427
Non-Interest Expenses:		
Salaries and employee benefits	2,219	2,318
Occupancy and equipment	757	758
Other	1,399	1,509
Total non-interest expenses	4,375	4,585
Income before provision for income taxes	954	350
Provision for Income Taxes	338	126
Net income	$ 616	$ 224
Preferred Stock Dividends and Discount Accretion	(171)	(171)
Net income available to common shareholders	$ 445	$ 53
Basic income per common share	$ 0.09	$ 0.01
Diluted income per common share	$ 0.09	$ 0.01

See notes to unaudited condensed consolidated financial statements.

PLUMAS BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)

	For the Three Months Ended March 31, 2013	2012
Net income	$ 616	$ 224
Other comprehensive (loss) income:		
Change in net unrealized gains, net	(287)	120
Less: Reclassification adjustments for net gains included in net income		(51)
Net unrealized holding (losses) gains	(287)	69
Income tax effect	119	(28)
Other comprehensive (loss) income	(168)	41
Total comprehensive income	$ 448	$ 265

See notes to unaudited condensed consolidated financial statements.

PLUMAS BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	For the Three Months Ended March 31, 2013	2012
Cash Flows from Operating Activities:		
Net income	$ 616	$ 224
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	700	600
Change in deferred loan origination costs/fees, net	(208)	(182)
Depreciation and amortization	342	317
Stock-based compensation expense	9	66
Amortization of investment security premiums	114	157
Gain on sale of investments		(51)
Gain on sale of loans held for sale	(521)	(234)
Loans originated for sale	(4,577)	(3,307)
Proceeds from loan sales	7,672	4,234
Provision from change in OREO valuation	114	187
Earnings on bank-owned life insurance	(91)	(85)
Decrease (increase) decrease in accrued interest receivable and other assets	512	(114)
(Decrease) increase in accrued interest payable and other liabilities	(972)	56
Net cash provided by operating activities	3,710	1,868
Cash Flows from Investing Activities:		
Proceeds from matured and called available-for-sale investment securities	6,000	6,180
Proceeds from principal repayments from available-for-sale government-sponsored mortgage-backed securities	2,242	2,327
Purchases of available-for-sale securities	(8,122)	(12,873)
Proceeds from sale of available-for-sale securities		4,471
Net increase in loans	(1,711)	(1,273)
Proceeds from sale of other real estate	243	499
Proceeds from sale of other vehicles	51	20
Purchase of premises and equipment	(20)	(116)
Net cash used in investing activities	(1,317)	(765)

Continued on next page.

PLUMAS BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

(Continued)

	For the Three Months Ended March 31, 2013	2012
Cash Flows from Financing Activities:		
Net increase in demand, interest bearing and savings deposits	$ 3,804	$ 9,333
Net decrease in time deposits	(3,134)	(1,855)
Net increase (decrease) in securities sold under agreements to repurchase	24	(2,996)
Net cash provided by financing activities	694	4,482
Increase in cash and cash equivalents	3,087	5,585
Cash and Cash Equivalents at Beginning of Year	44,675	63,076
Cash and Cash Equivalents at End of Period	$ 47,762	$ 68,661
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for:		
Interest expense	$ 1,146	$ 266
Non-Cash Investing Activities:		
Real estate and vehicles acquired through foreclosure	$ 364	$ 45

See notes to unaudited condensed consolidated financial statements.

PLUMAS BANCORP

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. GENERAL

During 2002, Plumas Bancorp (the Company) was incorporated as a bank holding company for the purpose of acquiring Plumas Bank (the Bank) in a one bank holding company reorganization. This corporate structure gives the Company and the Bank greater flexibility in terms of operation expansion and diversification. The Company formed Plumas Statutory Trust I (Trust I) for the sole purpose of issuing trust preferred securities on September 26, 2002. The Company formed Plumas Statutory Trust II (Trust II) for the sole purpose of issuing trust preferred securities on September 28, 2005.

The Bank operates eleven branches in California, including branches in Alturas, Chester, Fall River Mills, Greenville, Kings Beach, Portola, Quincy, Redding, Susanville, Tahoe City, and Truckee. The Bank s administrative headquarters is in Quincy, California. In addition, the Bank operates a loan administrative office in Reno, Nevada and a lending office specializing in government-guaranteed lending in Auburn, California. The Bank s primary source of revenue is generated from providing loans to customers who are predominately small and middle market businesses and individuals residing in the surrounding areas.

On July 21, 2010, President Barack Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), which, in part, permanently raised the current standard maximum deposit insurance amount to $250,000. In addition, amendments to the Dodd-Frank Act extended unlimited FDIC insurance coverage for noninterest-bearing transaction deposit accounts for an additional two years. This unlimited insurance coverage for noninterest-bearing transaction accounts expired on December 31, 2012.

2. REGULATORY MATTERS

On February 15, 2012, the Bank received notice from the Federal Deposit Insurance Corporation (FDIC) and the California Department of Financial Institutions (DFI) that the Consent Order with the FDIC and the DFI which was effective on March 16, 2011 had been terminated. While the Bank is no longer subject to an Order, the Bank entered into an informal agreement with the FDIC and DFI which, among other things, requests that the Bank continue to maintain a Tier 1 Leverage Capital Ratio of 9% which is in excess of that required for well capitalized institutions and continue to reduce its level of classified asset balances that were outstanding as of September 30, 2011 to not more than 50% of Tier 1 Capital plus the allowance for loan losses. At December 31, 2012 this ratio was 32% and the Bank s Tier 1 Leverage Capital Ratio was 10.4%. The FDIC and DFI terminated the informal agreement effective January 24, 2013.

On July 28, 2011 the Company entered into an agreement with the Federal Reserve Bank of San Francisco (the FRB Agreement). Under the terms of the FRB Agreement, Plumas Bancorp has agreed to take certain actions that are designed to maintain its financial soundness so that it may continue to serve as a source of strength to the Bank. Among other things, the FRB Agreement requires prior written approval related to the payment or taking of dividends and distributions, making any distributions of interest, principal or other sums on subordinated debentures or trust preferred securities, incurrence of debt, and the purchase or redemption of stock. In March 2013 the FRB allowed Plumas Bancorp to pay all past due and current interest on its trust preferred securities. As of March 31, 2013 the amount of the arrearage on the dividend payments of the Series A Preferred Stock is $1.8 million representing twelve quarterly payments.

On April 19, 2013 the Company received notice that the FRB Agreement had been terminated.

3. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements include the accounts of the Company and the accounts of its wholly-owned subsidiary, Plumas Bank. Plumas Statutory Trust I and Plumas Statutory Trust II are not consolidated into the Company s consolidated financial statements and, accordingly, are accounted for under the equity method. In the opinion of management, the unaudited condensed consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the Company s financial position at March 31, 2013 and the results of its operations and its cash flows for the three-month periods ended March 31, 2013 and 2012. Our condensed consolidated balance sheet at December 31, 2012 is derived from audited financial statements. Certain reclassifications have been made to prior period s balances to conform to classifications used in 2013.

The unaudited condensed consolidated financial statements of the Company have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) for interim reporting on Form 10-Q. Accordingly, certain disclosures normally presented in the notes to the annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been omitted. The Company believes that the disclosures are adequate to make the information not misleading. These interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s 2012 Annual Report to Shareholders on Form 10-K. The results of operations for the three-month period ended March 31, 2013 may not necessarily be indicative of future operating results. In preparing such financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the periods reported. Actual results could differ significantly from those estimates.

Management has determined that because all of the commercial banking products and services offered by the Company are available in each branch of the Bank, all branches are located within the same economic environment and management does not allocate resources based on the performance of different lending or transaction activities, it is appropriate to aggregate the Bank branches and report them as a single operating segment. No single customer accounts for more than 10% of the revenues of the Company or the Bank.

4. INVESTMENT SECURITIES AVAILABLE FOR SALE

The amortized cost and estimated fair value of investment securities at March 31, 2013 and December 31, 2012 consisted of the following:

	March 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government-sponsored agencies	$ 33,254,000	$ 128,000	$ (1,000)	$ 33,381,000
U.S. Government-sponsored agencies collateralized by mortgage obligations - residential	46,918,000	257,000	(110,000)	47,065,000
	$ 80,172,000	$ 385,000	$ (111,000)	$ 80,446,000

Unrealized gains on available-for-sale investment securities totaling $274,000 were recorded, net of $113,000 in tax expense, as accumulated other comprehensive income within shareholders equity at March 31, 2013. During the three months ended March 31, 2012, the Company sold three available-for-sale securities for total proceeds of $4,471,000, which resulted in the recognition of a $51,000 gross gain on sale. No securities were sold during the three months ended March 31, 2013.

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government-sponsored agencies	$ 38,291,000	$ 154,000	$ (3,000)	$ 38,442,000
U.S. Government-sponsored agencies collateralized by mortgage obligations - residential	42,112,000	434,000	(24,000)	42,522,000
	$ 80,403,000	$ 588,000	$ (27,000)	$ 80,964,000

Net unrealized gains on available-for-sale investment securities totaling $561,000 were recorded, net of $232,000 in tax expense, as accumulated other comprehensive income within shareholders equity at December 31, 2012. During the year ended December 31, 2012, the Company sold twenty-five available-for-sale investment securities for $20,773,000, recording a $403,000 gain on sale. No securities were sold at a loss.

Investment securities with unrealized losses at March 31, 2013 are summarized and classified according to the duration of the loss period as follows:

	Less than 12 Months	
	Fair Value	Unrealized Losses
Debt securities:		
U.S. Government-sponsored agencies	$ 998,000	$ 1,000
U.S. Government-sponsored agencies collateralized by mortgage obligations	19,726,000	110,000
	$ 20,724,000	$ 111,000

Investment securities with unrealized losses at December 31, 2012 are summarized and classified according to the duration of the loss period as follows:

	Less than 12 Months	
	Fair Value	Unrealized Losses
Debt securities:		
U.S. Government-sponsored agencies	$ 2,004,000	$ 3,000
U.S. Government-sponsored agencies collateralized by mortgage obligations	7,002,000	24,000
	$ 9,006,000	$ 27,000

There were no securities in a loss position for more than one year as of March 31, 2013 and December 31, 2012.

At March 31, 2013, the Company held 57 securities of which 16 were in a loss position. Of the securities in a loss position, all were in a loss position for less than twelve months. Of the 16 securities, 1 is a U.S. Government-sponsored agencies and 15 are U.S. Government-sponsored agencies collateralized by mortgage obligations. The unrealized losses primarily relate to changes in interest rates and other market conditions. All of the securities continue to pay as scheduled. When analyzing an issuer s financial condition, management considers the length of time and extent to which the market value has been less than cost; the historical and implied volatility of the security; the financial condition of the issuer of the security; and the Company s intent and ability to hold the security to recovery. As of March 31, 2013, management does not have the intent to sell these securities nor does it believe it is more likely than not that it will be required to sell these securities before the recovery of its amortized cost basis. Based on the Company s evaluation of the above and other relevant factors, the Company does not believe the securities that are in an unrealized loss position as of March 31, 2013 are other than temporarily impaired.

The amortized cost and estimated fair value of investment securities at March 31, 2013 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	Estimated Amortized Cost	Estimated Fair Value
Within one year	1,000,000	1,005,000
After one year through five years	32,254,000	32,376,000
Investment securities not due at a single maturity date:		
Government-guaranteed mortgage- backed securities	46,918,000	47,065,000
	$ 80,172,000	$ 80,446,000

Investment securities with amortized costs totaling $47,300,000 and $44,305,000 and estimated fair values totaling $47,542,000 and $44,535,000 at March 31, 2013 and December 31, 2012, respectively, were pledged to secure deposits and repurchase agreements.

5. LOANS AND THE ALLOWANCE FOR LOAN LOSSES

Outstanding loans are summarized below, in thousands:

	March 31, 2013	December 31, 2012
Commercial	$ 28,777	$ 29,552
Agricultural	32,864	35,124
Real estate residential	32,679	34,666
Real estate commercial	138,775	139,546
Real estate construction and land development	16,811	15,801
Equity lines of credit	37,204	36,873
Auto	22,288	19,283
Other	3,762	4,212
	313,160	315,057
Deferred loan costs, net	1,053	900
Allowance for loan losses	(5,777)	(5,686)
	$ 308,436	$ 310,271

The recorded investment in impaired loans totaled $16,864,000 and $18,850,000 at March 31, 2013 and December 31, 2012. The Company had specific allowances for loan losses of $1,371,000 on impaired loans of $7,213,000 at March 31, 2013 as compared to specific allowances for loan losses of $1,186,000 on impaired loans of $14,334,000 at December 31, 2012. The balance of impaired loans in which no specific reserves were required totaled $9,651,000 and $4,516,000 at March 31, 2013 and December 31, 2012, respectively. The average recorded investment in impaired loans for the three months ended March 31, 2013 and March 31, 2012 was $17,440,000 and $23,944,000, respectively. The Company recognized $103,000 and $127,000 in interest income on a cash basis for impaired loans during the three months ended March 31, 2013 and 2012, respectively.

Included in impaired loans are troubled debt restructurings. A troubled debt restructuring is a formal restructure of a loan where the Company for economic or legal reasons related to the borrower s financial difficulties, grants a concession to the borrower. The concessions may be granted in various forms, one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

The carrying value of troubled debt restructurings at March 31, 2013 and December 31, 2012 was $12,149,000 and $12,296,000, respectively. The Company has allocated $985,000 and $348,000 of specific reserves on loans to customers whose loan terms have been modified in troubled debt restructurings as of March 31, 2013 and December 31, 2011, respectively. The Company was not committed to lend additional amounts on loans classified as troubled debt restructurings at March 31, 2013 and December 31, 2012.

During the three month period ended March 31, 2013 and December 31, 2012, the terms of certain loans were modified as troubled debt restructurings. Modifications involving a reduction of the stated interest rate of the loan was for periods ranging from 1 month to 10 years. For the periods described above, modifications involving an extension of the maturity date were for periods ranging from 1 month to 10 years.

The following table presents loans by class modified as troubled debt restructurings that occurred during the three months ending March 31, 2013:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Recorded Investment
Troubled Debt Restructurings:			
Dealer	1	7,564	7,494

Total	1	$ 7,564	$ 7,494

The troubled debt restructuring described above resulted in no allowance for loan losses or charge-offs during the three months ending March 31, 2013.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the three months ended March 31, 2013.

	Number of Loans	Recorded Investment
Troubled Debt Restructurings:		
Real estate commercial	1	$ 1,150,000
Total	1	$ 1,150,000

The following table presents loans by class modified as troubled debt restructurings that occurred during the twelve months ending December 31, 2012:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Recorded Investment
Troubled Debt Restructurings:			
Commercial	1	$ 24,000	$ 24,000
Real Estate:			
Residential	2	819,000	800,000
Construction and land development	3	289,000	289,000
Commercial	3	2,497,000	2,491,000
Dealer	2	11,000	11,000
Total	11	$ 3,640,000	$ 3,615,000

The troubled debt restructurings described above decreased the allowance for loan losses by $118,000 during the twelve months ending December 31, 2012. The troubled debt restructurings described above did not result in charge offs during the twelve months ending December 31, 2012.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the twelve months ended December 31, 2012.

	Number of Loans	Recorded Investment
Troubled Debt Restructurings:		
Real estate construction	1	$ 2,978,000
Total	1	$ 2,978,000

The terms of certain other loans were modified during the three months ending March 31, 2013 and year ending December 31, 2012 that did not meet the definition of a troubled debt restructuring. These loans have a total recorded investment as of March 31, 2013 and December 31, 2012 of $874 thousand and $9 million, respectively.

These loans which were modified during the three month ended March 31, 2013 and year ended December 31, 2012 did not meet the definition of a troubled debt restructuring as the modification was a delay in a payment ranging from 30 days to 3 months that was considered to be insignificant or the borrower was not considered to be experiencing financial difficulties.

At March 31, 2013 and December 31, 2012, nonaccrual loans totaled $12,974,000 and $13,683,000, respectively. Interest foregone on nonaccrual loans totaled $180,000 and $200,000 for the three months ended March 31, 2013 and 2012, respectively. Loans past due 90 days or more and on accrual status totaled $1,258,000 and $15,000 at March 31, 2013 and December 31, 2012.

Salaries and employee benefits totaling $294,000 and $195,000 have been deferred as loan origination costs during the three months ended March 31, 2013 and 2012, respectively.

The Company assigns a risk rating to all loans and periodically, but not less than annually, performs detailed reviews of all such loans over $100,000 to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the Company and the Company s regulators. During these internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual loan.

The risk ratings can be grouped into five major categories, defined as follows:

Pass A pass loan is a strong credit with no existing or known potential weaknesses deserving of management s close attention.

Watch A Watch loan has potential weaknesses that deserve management s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the Company s credit position at some future date. Watch loans are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification.

Substandard A substandard loan is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Well defined weaknesses include a project s lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time or the project s failure to fulfill economic expectations. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful Loans classified 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 known facts, conditions and values, highly questionable and improbable.

Loss Loans classified as loss are considered uncollectible and charged off immediately.

The following table shows the loan portfolio allocated by management s internal risk ratings at the dates indicated, in thousands:

March 31, 2013

	Commercial Credit Exposure Credit Risk Profile by Internally Assigned Grade						
	Commercial	Agricultural	Real Estate-Residential	Real Estate-Commercial	Real Estate-Construction	Equity LOC	Total
Grade:							
Pass	$ 26,421	$ 31,477	$ 30,012	$ 129,184	$ 11,905	$ 34,895	$ 263,894
Watch	941	511	682	4,846	175	156	7,311
Substandard	1,393	876	1,985	4,745	4,731	2,128	15,858
Doubtful	22					25	47
Total	$ 28,777	$ 32,864	$ 32,679	$ 138,775	$ 16,811	$ 37,204	$ 287,110

December 31, 2012

	Commercial Credit Exposure Credit Risk Profile by Internally Assigned Grade						
	Commercial	Agricultural	Real Estate-Residential	Real Estate-Commercial	Real Estate-Construction	Equity LOC	Total
Grade:							
Pass	$ 27,260	$ 33,801	$ 31,239	$ 128,919	$ 10,863	$ 34,142	$ 266,224
Watch	1,145	466	751	3,237	149	965	6,713
Substandard	1,138	857	2,676	7,390	4,789	1,766	18,616
Doubtful	9						9
Total	$ 29,552	$ 35,124	$ 34,666	$ 139,546	$ 15,801	$ 36,873	$ 291,562

	Consumer Credit Exposure Credit Risk Profile Based on Payment Activity March 31, 2013			Consumer Credit Exposure Credit Risk Profile Based on Payment Activity December 31, 2012		
	Auto	Other	Total	Auto	Other	Total
Grade:						
Performing	$ 22,251	$ 3,721	$ 25,972	$ 19,239	$ 4,193	$ 23,432
Non-performing	37	41	78	44	19	63
Total	$ 22,288	$ 3,762	$ 26,050	$ 19,283	$ 4,212	$ 23,495

The following tables show the allocation of the allowance for loan losses by impairment methodology at the dates indicated, in thousands:

Allowance for Loan Losses

Three months ended

	Commercial	Agricultural	Real Estate-Residential	Real Estate-Commercial	Real Estate-Construction	Equity LOC	Auto	Other	Total
March 31, 2013:									
Beginning balance	$ 855	$ 159	$ 894	$ 1,656	$ 950	$ 736	$ 289	$ 147	$ 5,686
Charge-offs	(153)		(221)	(132)	(55)		(22)	(63)	(646)
Recoveries	9			2			17	9	37
Provision	75	6	(19)	(108)	705	(28)	6	63	700
Ending balance	$ 786	$ 165	$ 654	$ 1,418	$ 1,600	$ 708	$ 290	$ 156	$ 5,777
March 31, 2012:									
Beginning balance	$ 1,025	$ 330	$ 698	$ 1,925	$ 2,006	$ 635	$ 95	$ 194	$ 6,908
Charge-offs	(252)	(250)	(39)	(97)	(122)		(7)	(77)	(844)
Recoveries	10			2		3	6	37	58
Provision	320	136	(125)	9	126	95	2	37	600
Ending balance	$ 1,103	$ 216	$ 534	$ 1,839	$ 2,010	$ 733	$ 96	$ 191	$ 6,722
March 31, 2013:									
Allowance for Loan Losses									
Ending balance	$ 786	$ 165	$ 654	$ 1,418	$ 1,600	$ 708	$ 290	$ 156	$ 5,777
Ending balance: individually evaluated for impairment	$ 128	$	$ 235	$ 92	$ 711	$ 181	$	$ 24	$ 1,371
Ending balance: collectively evaluated for impairment	$ 658	$ 165	$ 419	$ 1,326	$ 889	$ 527	$ 290	$ 132	$ 4,406
Loans									
Ending balance	$ 28,777	$ 32,864	$ 32,679	$ 138,775	$ 16,811	$ 37,204	$ 22,288	$ 3,762	$ 313,160
Ending balance: individually evaluated for impairment	$ 2,668	$ 666	$ 3,136	$ 3,447	$ 5,132	$ 1,755	$ 36	$ 24	$ 16,864
Ending balance: collectively evaluated for impairment	$ 26,109	$ 32,198	$ 29,543	$ 135,328	$ 11,679	$ 35,449	$ 22,252	$ 3,738	$ 296,296
December 31, 2012:									
Allowance for Loan Losses									
Ending balance	$ 855	$ 159	$ 894	$ 1,656	$ 950	$ 736	$ 289	$ 147	$ 5,686
Ending balance: individually evaluated for impairment	$ 192	$ 1	$ 459	$ 284	$ 68	$ 180	$	$ 2	$ 1,186
Ending balance: collectively evaluated for impairment	$ 663	$ 158	$ 435	$ 1,372	$ 882	$ 556	$ 289	$ 145	$ 4,500
Loans									

Ending balance	$ 29,552	$ 35,124	$ 34,666	$ 139,546	$ 15,801	$ 36,873	$ 19,283	$ 4,212	$ 315,057
Ending balance: individually evaluated for impairment	$ 3,478	$ 647	$ 3,598	$ 4,528	$ 5,191	$ 1,360	$ 44	$ 4	$ 18,850
Ending balance: collectively evaluated for impairment	$ 26,074	$ 34,477	$ 31,068	$ 135,018	$ 10,610	$ 35,513	$ 19,239	$ 4,208	$ 296,207

The following table shows an aging analysis of the loan portfolio by the time past due, in thousands:

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
As of March 31, 2013:						
Commercial:						
Commercial	$ 152	$	$ 2,534	$ 2,686	$ 26,091	$ 28,777
Agricultural	384		380	764	32,100	32,864
Real estate construction	166	1,241	3,344	4,751	12,060	16,811
Real estate commercial			3,447	3,447	135,328	138,775
Residential:						
Real estate residential	234		1,453	1,687	30,992	32,679
Equity LOC	142		1,755	1,897	35,307	37,204
Consumer:						
Auto	180		37	217	22,071	22,288
Other	58	17	24	99	3,663	3,762
Total	$ 1,316	$ 1,258	$ 12,974	$ 15,548	$ 297,612	$ 313,160
As of December 31, 2012:						
Commercial:						
Commercial	$ 329	$	$ 3,303	$ 3,632	$ 25,920	$ 29,552
Agricultural			380	380	34,744	35,124
Real estate construction	156		3,314	3,470	12,331	15,801
Real estate commercial	1,271		3,378	4,649	134,897	139,546
Residential:						
Real estate residential	242		1,911	2,153	32,513	34,666
Equity LOC	527		1,349	1,876	34,997	36,873
Consumer:						
Auto	151	11	44	206	19,077	19,283
Other	102	4	4	110	4,102	4,212
Total	$ 2,778	$ 15	$ 13,683	$ 16,476	$ 298,581	$ 315,057

The following table shows information related to impaired loans at the dates indicted, in thousands:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
As of March 31, 2013:					
With no related allowance recorded:					
Commercial	$ 2,222	$ 2,812		$ 2,506	$ 18
Agricultural	666	1,147		655	6
Real estate construction	1,629	1,703		1,741	26
Real estate commercial	1,534	1,606		2,564	
Real estate residential	2,485	2,495		2,635	28
Equity Lines of Credit	1,079	1,155		921	1
Auto	36	36		40	1
Other				37	
With an allowance recorded:					
Commercial	446	446	$ 128	440	
Agricultural					
Real estate construction	3,503	4,928	711	3,503	7
Real estate commercial	1,913	1,913	92	1,069	13
Real estate residential	651	651	235	653	3
Equity Lines of Credit	676	812	181	670	
Auto					
Other	24	24	24	6	
Total:					
Commercial	2,668	3,258	128	2,946	18
Agricultural	666	1,147		655	6
Real estate construction	5,132	6,631	711	5,244	33
Real estate commercial	3,447	3,519	92	3,633	13
Real estate residential	3,136	3,146	235	3,288	31
Equity Lines of Credit	1,755	1,967	181	1,591	1
Auto	36	36		40	1
Other	24	24	24	43	
Total	$ 16,864	$ 19,728	$ 1,371	$ 17,440	$ 103
As of December 31, 2012:					
With no related allowance recorded:					
Commercial	$ 1,022	$ 1,398		$ 1,597	$ 16
Agricultural	245	725		573	39
Real estate construction	1,429	1,503		1,106	98
Real estate commercial	941	1,013		1,997	96
Real estate residential	343	354		1,336	28
Equity Lines of Credit	490	490		613	22
Auto	44	44		60	5
Other	2	2		45	6
With an allowance recorded:					
Commercial	2,456	2,849	$ 192	2,765	20
Agricultural	402	402	1	403	20
Real estate construction	3,762	5,187	68	2,056	35
Real estate commercial	3,587	3,588	284	3,473	102
Real estate residential	3,255	3,255	459	2,818	105
Equity Lines of Credit	870	1,082	180	974	5
Auto					
Other	2	2	2		
Total:					
Commercial	3,478	4,247	192	4,362	36
Agricultural	647	1,127	1	976	59

Real estate construction	5,191	6,690	68	3,162	133
Real estate commercial	4,528	4,601	284	5,470	198
Real estate residential	3,598	3,609	459	4,154	133
Equity Lines of Credit	1,360	1,572	180	1,587	27
Auto	44	44		60	5
Other	4	4	2	45	6
Total	$ 18,850	$ 21,894	$ 1,186	$ 19,816	$ 597

6. COMMITMENTS AND CONTINGENCIES

The Company is party to claims and legal proceedings arising in the ordinary course of business. In the opinion of the Company s management, the amount of ultimate liability with respect to such proceedings will not have a material adverse effect on the financial condition or result of operations of the Company taken as a whole.

In the normal course of business, there are various outstanding commitments to extend credit, which are not reflected in the financial statements, including loan commitments of $83,298,000 and $76,030,000 and stand-by letters of credit of $70,000 and $110,000 at March 31, 2013 and December 31, 2012, respectively.

Of the loan commitments outstanding at March 31, 2013, $7,824,000 are real estate construction loan commitments that are expected to fund within the next twelve months. The remaining commitments primarily relate to revolving lines of credit or other commercial loans, and many of these are expected to expire without being drawn upon. Therefore, the total commitments do not necessarily represent future cash requirements. Each loan commitment and the amount and type of collateral obtained, if any, are evaluated on an individual basis. Collateral held varies, but may include real property, bank deposits, debt or equity securities or business assets.

Stand-by letters of credit are conditional commitments written to guarantee the performance of a customer to a third party. These guarantees are primarily related to the purchases of inventory by commercial customers and are typically short-term in nature. Credit risk is similar to that involved in extending loan commitments to customers and accordingly, evaluation and collateral requirements similar to those for loan commitments are used. The deferred liability related to the Company s stand-by letters of credit was not significant at March 31, 2013 or December 31, 2012.

7. EARNINGS PER SHARE

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which shares in the earnings of the Company. The treasury stock method has been applied to determine the dilutive effect of stock options in computing diluted earnings per share.

	For the Three Months Ended March 31,	
(In thousands, except per share data)	2013	2012
Net Income:		
Net income	$ 616	$ 224
Dividends and discount accretion on preferred shares	(171)	(171)
Net income available to common shareholders	$ 445	$ 53
Earnings Per Share:		
Basic earnings per share	$ 0.09	$ 0.01
Diluted earnings per share	$ 0.09	$ 0.01
Weighted Average Number of Shares Outstanding:		
Basic shares	4,776	4,776
Diluted shares	4,831	4,776

Shares of common stock issuable under stock options and warrants for which the exercise prices were greater than the average market prices were not included in the computation of diluted earnings per share due to their antidilutive effect. Stock options and warrants not included in the computation of diluted earnings per share, due to shares not being in the-money and having an antidilutive effect, were approximately 439,000 and 718,000 for the three month periods ended March 31, 2013 and 2012, respectively.

8. STOCK-BASED COMPENSATION

In 2001, the Company established a Stock Option Plan for which 410,293 shares of common stock remain reserved for issuance to employees and directors and no shares are available for future grants as of March 31, 2013. The Plan requires that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid in full at the time the option is exercised. Payment in full for the option price must be made in cash or with Company common stock previously acquired by the optionee and held by the optionee for a period of at least six months. The Plan does not provide for the settlement of awards in cash and new shares are issued upon option exercise. The options expire on dates determined by the Board of Directors, but not later than ten years from the date of grant. Upon grant, options vest ratably over a three to five year period.

The Company determines the fair value of the options previously granted on the date of grant using a Black-Scholes-Merton option pricing model that uses assumptions based on expected option life, expected stock volatility and the risk-free interest rate. The expected volatility assumptions used by the Company are based on the historical volatility of the Company s common stock over the most recent period commensurate with the estimated expected life of the Company s stock options. The Company bases its expected life assumption on its historical experience and on the terms and conditions of the stock options it grants to employees. The risk-free rate is based on the U.S. Treasury yield curve for the periods within the contractual life of the options in effect at the time of the grant. The Company also makes assumptions regarding estimated forfeitures that will impact the total compensation expenses recognized under the Plan.

During the three months ended March 31, 2013, the Company recognized compensation costs of $9,000 and no increase in future income tax benefit. During the three months ended March 31, 2012, the Company recognized compensation cost of $66,000 and an increase in future income tax benefit of $1,000.

The following table summarizes information about stock option activity for the three months ended March 31, 2013:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Intrinsic Value (in thousands)
Options outstanding at December 31, 2012	419,806	$ 8.67		
Options granted				
Options exercised				
Options cancelled	(9,513)	$ 9.70		
Options outstanding at March 31, 2013	410,293	$ 8.65	4.0	$ 479
Options exercisable at March 31, 2013	305,700	$ 10.60	3.4	$ 240
Expected to vest after March 31, 2013	87,939	$ 2.95	6.0	$ 201

At March 31, 2013, there was $78,000 of total unrecognized compensation cost related to non-vested stock option awards which is expected to be recognized over a weighted-average period of 2.0 years. The total fair value of options vested during the three months ended March 31, 2013 was $52,000.

9. INCOME TAXES

The Company files its income taxes on a consolidated basis with its subsidiary. The allocation of income tax expense (benefit) represents each entity s proportionate share of the consolidated provision for income taxes.

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amount of assets and liabilities and their tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The realization of deferred income tax assets is assessed and a valuation allowance is recorded if it is more likely than not that all or a portion of the deferred tax asset will not be realized. More likely than not is defined as greater than a 50% chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed.

At March 31, 2013 total deferred tax assets were approximately $6.5 million and total deferred tax liabilities were approximately $1.4 million for a net deferred tax asset of $5.1 million. The Company s deferred tax assets primarily relate to net operating loss carry-forwards and timing differences in the tax deductibility of the provision for loan losses, impairment charges on other real estate owned and deferred compensation. Based upon our analysis of available evidence, management of the Company determined that it is more likely than not that all of our deferred income tax assets as of March 31, 2013 and December 31, 2012 will be fully realized and therefore no valuation allowance was recorded. On the consolidated balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

Interest expense and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the consolidated statement of income. There have been no significant changes to unrecognized tax benefits or accrued interest and penalties for the three months ended March 31, 2013.

10. FAIR VALUE MEASUREMENT

The Company measures fair value under the fair value hierarchy described below.

Level 1: Quoted prices for identical instruments traded in active exchange markets.

Level 2: Quoted prices (unadjusted) for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3: Model based techniques that use one significant assumption not observable in the market. These unobservable assumptions reflect the Company s estimates of assumptions that market participants would use on pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings.

Fair Value of Financial Instruments

The carrying amounts and estimated fair values of financial instruments, at March 31, 2013 and December 31, 2012 are as follows:

		Fair Value Measurements at March 31, 2013 Using:			
	Carrying Value	Level 1	Level 2	Level 3	Total Fair Value
Financial assets:					
Cash and cash equivalents	$ 47,762,000	$ 47,762,000			$ 47,762,000
Investment securities	80,446,000		$ 80,446,000		80,446,000
Loans, net	308,436,000			$ 312,353,000	312,353,000
FHLB stock	1,950,000				N/A
Accrued interest receivable	1,523,000		196,000	1,327,000	1,523,000
Financial liabilities:					
Deposits	412,232,000	344,790,000	67,561,000		412,351,000
Repurchase Agreements	7,401,000		7,401,000		7,401,000
Junior subordinated deferrable interest debentures	10,310,000			5,702,000	5,702,000
Accrued interest payable	234,000	6,000	92,000	136,000	234,000

		Fair Value Measurements at December 31, 2012 Using:			
	Carrying Value	Level 1	Level 2	Level 3	Total Fair Value
Financial assets:					
Cash and cash equivalents	$ 44,675,000	$ 44,675,000			$ 44,675,000
Investment securities	80,964,000		$ 80,964,000		80,964,000
Loans, net	310,271,000			$ 313,929,000	313,929,000
FHLB stock	1,950,000				N/A
Accrued interest receivable	1,677,000		248,000	1,429,000	1,677,000
Financial liabilities:					
Deposits	411,562,000	340,986,000	70,696,000		411,682,000
Repurchase Agreements	7,377,000		7,377,000		7,377,000
Junior subordinated deferrable interest debentures	10,310,000			3,191,000	3,191,000
Accrued interest payable	1,115,000	6,000	90,000	1,019,000	1,115,0000

These estimates do not reflect any premium or discount that could result from offering the Company s entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

The following methods and assumptions were used by management to estimate the fair value of its financial instruments:

Cash and cash equivalents: The carrying amounts of cash and short-term instruments approximate fair values and are classified as Level 1.

Investment securities: Fair values for securities available for sale are generally determined by 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 by relying on the securities relationship to other benchmark quoted securities (Level 2).

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

FHLB stock: It was not practicable to determine the fair value of the FHLB stock due to restrictions placed on its transferability.

Deposits: The fair values disclosed for demand deposits, including interest and non-interest demand accounts, savings, and certain types of money market accounts are, by definition, equal to the carrying amount at the reporting date resulting in a Level 1 classification. Fair values for fixed rate certificates of deposit 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.

Repurchase agreements: The fair value of securities sold under repurchase agreements is estimated based on bid quotations received from brokers using observable inputs and are included as Level 2.

Junior subordinated deferrable interest debentures: The fair values of the Company s Subordinated Debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar