PLUMAS BANCORP
Form 10-Q
August 06, 2014

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 June 30, 2014

¨ **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 Incorporation or Organization)	**(I.R.S. Employer 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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate 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 August 4, 2014.
4,795,139 shares

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PLUMAS BANCORP

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except share data)

	June 30, 2014	December 31, 2013
Assets		
Cash and cash equivalents	$ 39,992	$ 49,917
Investment securities available for sale	90,768	90,343
Loans, less allowance for loan losses of $5,358 at June 30, 2014 and $5,517 at December 31, 2013	352,554	334,374
Premises and equipment, net	12,053	12,519
Bank owned life insurance	11,676	11,504
Real estate and vehicles acquired through foreclosure	3,914	6,459
Accrued interest receivable and other assets	10,277	10,609
Total assets	$ 521,234	$ 515,725
Liabilities and Shareholders Equity		
Deposits:		
Non-interest bearing	$ 170,847	$ 162,816
Interest bearing	285,869	286,623
Total deposits	456,716	449,439
Repurchase agreements	4,071	9,109
Note payable	3,000	3,000
Subordinated debenture	7,374	7,295
Accrued interest payable and other liabilities	6,154	5,979
Junior subordinated deferrable interest debentures	10,310	10,310
Total liabilities	487,625	485,132
Commitments and contingencies (Note 6)		
Shareholders equity:		
Common stock, no par value; 22,500,000 shares authorized; issued and outstanding 4,795,139 shares at June 30, 2014 and 4,787,739 at December 31, 2013	6,304	6,249
Retained earnings	27,574	25,507
Accumulated other comprehensive loss	(269)	(1,163)
Total shareholders equity	33,609	30,593

Total liabilities and shareholders equity	$ 521,234	$ 515,725

See notes to unaudited condensed consolidated financial statements.

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PLUMAS BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands, except per share data)

	For the Three Months Ended June 30, 2014	For the Three Months Ended June 30, 2013	For the Six Months Ended June 30, 2014	For the Six Months Ended June 30, 2013
Interest Income:				
Interest and fees on loans	$ 4,758	$ 4,580	$ 9,366	$ 8,896
Interest on investment securities	381	270	755	525
Other	26	25	55	48
Total interest income	5,165	4,875	10,176	9,469
Interest Expense:				
Interest on deposits	131	153	264	308
Interest on note payable	31		63	
Interest on subordinated debenture	189	160	377	160
Interest on junior subordinated deferrable interest debentures	75	76	149	159
Other	1	24	3	51
Total interest expense	427	413	856	678
Net interest income before provision for loan losses	4,738	4,462	9,320	8,791
Provision for Loan Losses	300	400	450	1,100
Net interest income after provision for loan losses	4,438	4,062	8,870	7,691
Non-Interest Income:				
Service charges	1,064	943	2,058	1,818
Gain on sale of loans	444	436	776	957
Other	385	318	748	623
Total non-interest income	1,893	1,697	3,582	3,398
Non-Interest Expenses:				
Salaries and employee benefits	2,393	2,081	4,762	4,301
Occupancy and equipment	757	666	1,536	1,422
Other	1,314	1,554	2,727	2,953
Total non-interest expenses	4,464	4,301	9,025	8,676
Income before provision for income taxes	1,867	1,458	3,427	2,413

Provision for Income Taxes	742	567	1,360	906
Net income	1,125	891	2,067	1,507
Discount on Redemption of Preferred Stock		530		530
Preferred Stock Dividends and Discount Accretion		(110)		(281)
Net income available to common shareholders	$ 1,125	$ 1,311	$ 2,067	$ 1,756
Basic earnings per share	$ 0.23	$ 0.27	$ 0.43	$ 0.37
Diluted earnings per share	$ 0.23	$ 0.27	$ 0.42	$ 0.36

See notes to unaudited condensed consolidated financial statements.

PLUMAS BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)

	For the Three Months Ended June 30, 2014	For the Three Months Ended June 30, 2013	For the Six Months Ended June 30, 2014	For the Six Months Ended June 30, 2013
Net income	$ 1,125	$ 891	$ 2,067	$ 1,507
Other comprehensive income (loss) :				
Change in net unrealized gains	984	(1,698)	1,522	(1,985)
Less: reclassification adjustments for net gains included in net income				
Net unrealized holding gains (losses)	984	(1,698)	1,522	(1,985)
Income tax effect	(406)	701	(628)	819
Other comprehensive income (loss)	578	(997)	894	(1,166)
Total comprehensive income (loss)	$ 1,703	$ (106)	$ 2,961	$ 341

See notes to unaudited condensed consolidated financial statements.

PLUMAS BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	For the Six Months Ended June 30, 2014	2013
Cash Flows from Operating Activities:		
Net income	$ 2,067	$ 1,507
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	450	1,100
Change in deferred loan origination costs/fees, net	(399)	(453)
Depreciation and amortization	649	715
Stock-based compensation expense	33	19
Amortization of investment security premiums	249	222
Gain on sale of OREO and other vehicles	(123)	(95)
Gain on sale of loans held for sale	(776)	(957)
Loans originated for sale	(9,075)	(7,581)
Proceeds from loan sales	11,769	13,777
Provision from change in OREO valuation	135	414
Earnings on bank-owned life insurance	(172)	(173)
(Increase) decrease in accrued interest receivable and other assets	(149)	1,089
Increase (decrease) in accrued interest payable and other liabilities	175	(1,181)
Net cash provided by operating activities	4,833	8,403
Cash Flows from Investing Activities:		
Proceeds from matured and called available-for-sale investment securities	16,044	13,000
Proceeds from principal repayments from available-for-sale government-sponsored mortgage-backed securities	4,576	4,332
Purchases of available-for-sale securities	(19,767)	(19,224)
Net increase in loans	(20,756)	(16,574)
Proceeds from sale of OREO	2,805	1,057
Proceeds from sale of other vehicles	160	77
Purchase of premises and equipment	(81)	(137)
Net cash used in investing activities	(17,019)	(17,469)

Continued on next page.

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PLUMAS BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

(Continued)

	For the Six Months Ended June 30, 2014	For the Six Months Ended June 30, 2013
Cash Flows from Financing Activities:		
Net increase in demand, interest bearing and savings deposits	$ 10,638	$ 24,981
Net decrease in time deposits	(3,361)	(4,259)
Issuance of subordinated debenture, net of discount		7,182
Issuance of common stock warrant		318
Repurchase of common stock warrant		(234)
Redemption of preferred stock		(8,036)
Payment of dividends on preferred stock		(1,938)
Net decrease in securities sold under agreements to repurchase	(5,038)	(1,937)
Proceeds from exercise of stock options	22	15
Net cash provided by financing activities	2,261	16,092
(Decrease) increase in cash and cash equivalents	(9,925)	7,026
Cash and Cash Equivalents at Beginning of Year	49,917	44,675
Cash and Cash Equivalents at End of Period	$ 39,992	$ 51,701
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for:		
Interest expense	$ 772	$ 1,248
Income taxes	1,200	30
Non-Cash Investing Activities:		
Real estate and vehicles acquired through foreclosure	$ 432	$ 2,831

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, lending offices specializing in government-guaranteed lending in Auburn, California and Beaverton, Oregon and a commercial/agricultural lending office in Chico, 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.

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. Effective February 8, 2012, the Bank entered into an informal agreement with the FDIC and DFI which, among other things, requested 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. Effective July 1, 2013, the California Department of Corporations and the DFI merged to form the Department of Business Oversight (DBO).

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 agreed to take certain actions that were 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 required 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. 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 June 30, 2014 and the results of its operations and its cash flows for the three-month and six month periods ended June 30, 2014 and 2013. Our condensed consolidated balance sheet at December 31, 2013 is derived from audited financial statements. Certain reclassifications have been made to prior period s balances to conform to classifications used in 2014.

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 2013 Annual Report to Shareholders on Form 10-K. The results of operations for the three-month and six-month periods ended June 30, 2014 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 June 30, 2014 and December 31, 2013 consisted of the following, in thousands:

	June 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale:				
Debt securities:				
U.S. Government-sponsored agencies	$ 13,057	$ 42	$ (21)	$ 13,078
U.S. Government-sponsored agencies collateralized by mortgage obligations-residential	71,816	232	(803)	71,245
Obligations of states and political subdivisions	5,851	97	(6)	5,942
Corporate debt securities	502	1		503
	$ 91,226	$ 372	$ (830)	$ 90,768

Net unrealized loss on available-for-sale investment securities totaling $458,000 were recorded, net of $189,000 in tax benefits, as accumulated other comprehensive income within shareholders equity at June 30, 2014. No securities were sold during the six months ended June 30, 2014.

	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale:				
Debt securities:				
U.S. Government-sponsored agencies	$ 27,132	$ 40	$ (75)	$ 27,097
U.S. Government-sponsored agencies collateralized by mortgage obligations-residential	63,807	22	(1,954)	61,875
Obligations of states and political subdivisions	1,384	4	(17)	1,371

	$ 92,323	$ 66	$ (2,046)	$ 90,343

Net unrealized loss on available-for-sale investment securities totaling $1,980,000 were recorded, net of $817,000 in tax benefits, as accumulated other comprehensive income within shareholders equity at December 31, 2013. No securities were sold during the year ended December 31, 2013.

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There were no transfers of available-for-sale investment securities during the six months ended June 30, 2014 and twelve months ended December 31, 2013. There were no securities classified as held-to-maturity at June 30, 2014 or December 31, 2013.

Investment securities with unrealized losses at June 30, 2014 and December 31, 2013 are summarized and classified according to the duration of the loss period as follows, in thousands:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2014						
Debt securities:						
U.S. Government-sponsored agencies	$	$	$ 3,983	$ 21	$ 3,983	$ 21
U.S. Government agencies collateralized by mortgage obligations-residential	5,324	14	38,390	789	43,714	803
Obligations of states and political subdivisions	1,816	6			1,816	6
	$ 7,140	$ 20	$ 42,373	$ 810	$ 49,513	$ 830
December 31, 2013						
Debt securities:						
U.S. Government-sponsored agencies	$ 5,930	$ 75	$	$	$ 5,930	$ 75
U.S. Government agencies collateralized by mortgage obligations-residential	53,603	1,700	4,317	254	57,920	1,954
Obligations of states and political subdivisions	928	17			928	17
	$ 60,461	$ 1,792	$ 4,317	$ 254	$ 64,778	$ 2,046

At June 30, 2014, the Company held 97 securities of which 48 were in a loss position. Of the securities in a loss position, all but 13 were in a loss position for less than twelve months. Of the 48 securities 4 are U.S. Government-sponsored agencies 36 are U.S. Government-sponsored agencies collateralized by residential mortgage obligations and 8 were obligations of states and political subdivisions. The unrealized losses relate principally to market rate 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 June 30, 2014, 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 June 30, 2014 are other than temporarily impaired.

The amortized cost and estimated fair value of investment securities at June 30, 2014 by contractual maturity are shown below, in thousands.

	Amortized Cost	Estimated Fair Value
Within one year	$ 3,057	$ 3,065
After one year through five years	10,502	10,515
After five years through ten years	3,931	4,010
After ten years	1,920	1,933
Investment securities not due at a single maturity date:		
Government-sponsored mortgage-backed securities	71,816	71,245
	$ 91,226	$ 90,768

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. Investment securities with amortized costs totaling $52,665,000 and $54,373,000 and estimated fair values totaling $52,413,000 and $53,493,000 June 30, 2014 and December 31, 2013, respectively, were pledged to secure deposits and repurchase agreements.

5. LOANS AND THE ALLOWANCE FOR LOAN LOSSES

Outstanding loans are summarized below, in thousands:

	June 30, 2014	December 31, 2013
Commercial	$ 32,882	$ 32,612
Agricultural	32,152	30,647
Real estate residential	29,364	31,322
Real estate commercial	161,205	155,942
Real estate construction and land development	20,904	17,793
Equity lines of credit	37,701	35,800
Auto	37,981	30,305
Other	4,124	4,130
	356,313	338,551
Deferred loan costs, net	1,599	1,340
Allowance for loan losses	(5,358)	(5,517)
	$ 352,554	$ 334,374

Changes in the allowance for loan losses, in thousands, were as follows:

	June 30, 2014	December 31, 2013
Balance, beginning of year	$ 5,517	$ 5,686
Provision charged to operations	450	1,400
Losses charged to allowance	(1,221)	(1,915)
Recoveries	612	346
Balance, end of year	$ 5,358	$ 5,517

The recorded investment in impaired loans totaled $8,854,000 and $9,815,000 at June 30, 2014 and December 31, 2013, respectively. The Company had specific allowances for loan losses of $824,000 on impaired loans of $2,604,000 at June 30, 2014 as compared to specific allowances for loan losses of $629,000 on impaired loans of $2,322,000 at December 31, 2013. The balance of impaired loans in which no specific reserves were required totaled $6,250,000 and $7,493,000 at June 30, 2014 and December 31, 2013, respectively. The average recorded investment in impaired loans for the six months ended June 30, 2014 and June 30, 2013 was $8,982,000 and $16,076,000, respectively. The Company recognized $64,000 and $210,000 in interest income on a cash basis for impaired loans during the six months ended June 30, 2014 and 2013, respectively. During the three months ended June 30, 2014 and 2013 the Company recognized ($31,000) and $107,000 in interest income on a cash basis for impaired loans, 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 to include 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.

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 the modification. This evaluation is performed under the Company s internal underwriting policy.

The carrying value of troubled debt restructurings at June 30, 2014 and December 31, 2013 was $6,590,000 and $7,616,000, respectively. The Company has allocated $455,000 and $284,000 of specific reserves on loans to customers whose loan terms have been modified in troubled debt restructurings as of June 30, 2014 and December 31, 2013, respectively. The Company has not committed to lend additional amounts on loans classified as troubled debt restructurings at June 30, 2014 and December 31, 2013.

There were no troubled debt restructurings that occurred during the six months ending June 30, 2014.

During the three and six month periods ended June 30, 2013, 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 and those with decreases in rates ranged from 0% to 1.5%.

The following table presents loans by class modified as troubled debt restructurings that occurred during the six months ending June 30, 2013, dollars in thousands:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Recorded Investment
Troubled Debt Restructurings:			
Auto	1	$ 8	$ 7
Total	1	$ 8	$ 7

The troubled debt restructurings described above resulted in no allowance for loan losses or charge-offs during the six months ending June 30, 2013. There were no new troubled debt restructurings during the three months ending June 30, 2013.

There were no troubled debt restructurings for which there was a payment default within twelve months following the modification during the six months ended June 30, 2014.

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 six months ended June 30, 2013, dollars in thousands.

	Number of Loans	Recorded Investment
Troubled Debt Restructurings:		
Real estate construction and land development	1	$ 1,150
Total	1	$ 1,150

The troubled debt restructuring described above increased the allowance for loan losses by $154,000 and resulted in no charge-offs during the six months ending June 30, 2013. There were no loans for which there was a payment default within twelve months following the modification during the three months ended June 30, 2013.

The terms of certain other loans were modified during the six months ending June 30, 2014 and year ending December 31, 2013 that did not meet the definition of a troubled debt restructuring. These loans have a total recorded investment as of June 30, 2014 and December 31, 2013 of $14 million and $14 million, respectively.

These loans which were modified during the six months ended June 30, 2014 and year ended December 31, 2013 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 June 30, 2014 and December 31, 2013, nonaccrual loans totaled $6,869,000 and $5,519,000, respectively. Interest foregone on nonaccrual loans totaled $204,000 and $170,000 for the six months ended June 30, 2014 and 2013, respectively. Interest foregone on nonaccrual loans totaled $103,000 and $80,000 for the three months ended June 30, 2014 and 2013, respectively. Loans past due 90 days or more and on accrual status totaled $21,000 and $17,000 at June 30, 2014 and December 31, 2013, respectively.

Salaries and employee benefits totaling $675,000 and $672,000 have been deferred as loan origination costs during the six months ended June 30, 2014 and 2013, respectively. Salaries and employee benefits totaling $334,000 and $378,000 have been deferred as loan origination costs during the three months ended June 30, 2014 and 2013, respectively.

The Company assigns a risk rating to all loans, with the exception of automobile and other 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:

June 30, 2014

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	$ 31,617	$ 31,704	$ 28,295	$ 154,452	$ 19,344	$ 36,846	$ 302,258
Watch	789	389	128	2,753		154	4,213
Substandard	476	59	941	4,000	1,560	701	7,737
Doubtful							
Total	$ 32,882	$ 32,152	$ 29,364	$ 161,205	$ 20,904	$ 37,701	$ 314,208

December 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	$ 30,477	$ 30,213	$ 30,007	$ 147,605	$ 17,733	$ 34,742	$ 290,777
Watch	1,420	345	346	3,484		157	5,752
Substandard	665	89	969	4,853	60	890	7,526
Doubtful	50					11	61
Total	$ 32,612	$ 30,647	$ 31,322	$ 155,942	$ 17,793	$ 35,800	$ 304,116

	Consumer Credit Exposure Credit Risk Profile Based on Payment Activity June 30, 2014			Consumer Credit Exposure Credit Risk Profile Based on Payment Activity December 31, 2013		
	Auto	Other	Total	Auto	Other	Total
Grade:						
Performing	$ 37,841	$ 4,099	$ 41,940	$ 30,228	$ 4,113	$ 34,341
Non-performing	140	25	165	77	17	94
Total	$ 37,981	$ 4,124	$ 42,105	$ 30,305	$ 4,130	$ 34,435

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

	Commercial	Agricultural	Real Estate-Residential	Real Estate-Commercial	Real Estate-Construction	Equity LOC	Auto	Other	Total
Six months ended June 30, 2014:									
Allowance for Loan Losses									
Beginning balance	$ 785	$ 164	$ 638	$ 1,774	$ 944	$ 613	$ 449	$ 150	$ 5,517
Charge-offs	(93)		(145)	(679)		(142)	(105)	(57)	(1,221)
Recoveries	27		27	1	491	13	21	32	612
Provision	(16)	47	(97)	590	(295)	119	101	1	450
Ending balance	$ 703	$ 211	$ 423	$ 1,686	$ 1,140	$ 603	$ 466	$ 126	$ 5,358
Three months ended June 30, 2014:									
Allowance for Loan Losses									
Beginning balance	$ 542	$ 177	$ 604	$ 1,962	$ 1,166	$ 711	$ 429	$ 124	$ 5,715
Charge-offs	(7)		(145)	(679)		(131)	(34)	(30)	(1,026)
Recoveries	14		8		329	1	9	8	369
Provision	154	34	(44)	403	(355)	22	62	24	300
Ending balance	$ 703	$ 211	$ 423	$ 1,686	$ 1,140	$ 603	$ 466	$ 126	$ 5,358
Six months ended June 30, 2013:									
Allowance for Loan Losses									
Beginning balance	$ 855	$ 159	$ 894	$ 1,656	$ 950	$ 736	$ 289	$ 147	$ 5,686
Charge-offs	(353)		(221)	(132)	(735)	(21)	(49)	(98)	(1,609)
Recoveries	28			11		1	28	18	86
Provision	190	24	(69)	120	671	(12)	83	93	1,100
Ending balance	$ 720	$ 183	$ 604	$ 1,655	$ 886	$ 704	$ 351	$ 160	$ 5,263
Three months ended June 30, 2013:									

Allowance for Loan Losses									
Beginning balance	$ 786	$ 165	$ 654	$ 1,418	$ 1,600	$ 708	$ 290	$ 156	$ 5,777
Charge-offs	(200)				(680)	(21)	(27)	(35)	(963)
Recoveries	19			9		1	11	9	49
Provision	115	18	(50)	228	(34)	16	77	30	400
Ending balance	$ 720	$ 183	$ 604	$ 1,655	$ 886	$ 704	$ 351	$ 160	$ 5,263
June 30, 2014:									
Allowance for Loan Losses									
Ending balance: individually evaluated for impairment	$ 114	$	$ 94	$ 282	$ 185	$ 149	$	$	$ 824
Ending balance: collectively evaluated for impairment	$ 589	$ 211	$ 329	$ 1,404	$ 955	$ 454	$ 466	$ 126	$ 4,534
Loans									
Ending balance	$ 32,882	$ 32,152	$ 29,364	$ 161,205	$ 20,904	$ 37,701	$ 37,981	$ 4,124	$ 356,313
Ending balance: individually evaluated for impairment	$ 947	$ 266	$ 2,473	$ 2,729	$ 1,662	$ 633	$ 140	$ 4	$ 8,854
Ending balance: collectively evaluated for impairment	$ 31,935	$ 31,886	$ 26,891	$ 158,476	$ 19,242	$ 37,068	$ 37,841	$ 4,120	$ 347,459

	Commercial	Agricultural	Real Estate- Residential	Real Estate- Commercial	Real Estate- Construction	Equity LOC	Auto	Other	Total
December 31, 2013:									
Allowance for Loan Losses									
Ending balance: individually evaluated for impairment	$ 79	$	$ 200	$ 232	$ 13	$ 105	$	$	$ 629
Ending balance: collectively evaluated for impairment	$ 706	$ 164	$ 438	$ 1,542	$ 931	$ 508	$ 449	$ 150	$ 4,888
Loans									
Ending balance	$ 32,612	$ 30,647	$ 31,322	$ 155,942	$ 17,793	$ 35,800	$ 30,305	$ 4,130	$ 338,551
Ending balance: individually evaluated for impairment	$ 1,324	$ 267	$ 2,475	$ 3,074	$ 1,737	$ 861	$ 77	$	$ 9,815
Ending balance: collectively evaluated for impairment	$ 31,288	$ 30,380	$ 28,847	$ 152,868	$ 16,056	$ 34,939	$ 30,228	$ 4,130	$ 328,736

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 June 30, 2014						
Commercial:						
Commercial	$ 29	$	$ 922	$ 951	$ 31,931	$ 32,882
Agricultural					32,152	32,152
Real estate construction	41		1,519	1,560	19,344	20,904
Real estate	106		2,729	2,835	158,370	161,205
Residential:						
Real estate	224		922	1,146	28,218	29,364
Equity LOC	239		633	872	36,829	37,701
Consumer:						
Auto	394		140	534	37,447	37,981
Other	71	21	4	96	4,028	4,124
Total	$ 1,104	$ 21	$ 6,869	$ 7,994	$ 348,319	$ 356,313

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
As of December 31, 2013						
Commercial:						
Commercial	$ 129	$	$ 1,295	$ 1,424	$ 31,188	$ 32,612
Agricultural					30,647	30,647
Real estate construction	25		18	43	17,750	17,793
Real estate	304		2,369	2,673	153,269	155,942
Residential:						
Real estate	695		899	1,594	29,728	31,322
Equity LOC	72		861	933	34,867	35,800
Consumer:						
Auto	244		77	321	29,984	30,305
Other	63	17		80	4,050	4,130
Total	$ 1,532	$ 17	$ 5,519	$ 7,068	$ 331,483	$ 338,551

The following tables show information related to impaired loans at the dates indicated, in thousands:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
As of June 30, 2014:					
With no related allowance recorded:					
Commercial	$ 808	$ 1,055		$ 791	$ 1
Agricultural	266	266		267	10
Real estate construction	1,034	1,034		1,087	
Real estate commercial	1,639	2,077		1,565	4
Real estate residential	2,077	2,088		2,056	42
Equity Lines of Credit	282	282		291	
Auto	140	140		73	
Other	4	4			
With an allowance recorded:					
Commercial	$ 139	$ 139	$ 114	$ 42	$
Agricultural					
Real estate construction	628	628	185	635	
Real estate commercial	1,090	1,090	282	1,426	
Real estate residential	396	403	94	396	7
Equity Lines of Credit	351	351	149	353	
Auto					
Other					
Total:					
Commercial	$ 947	$ 1,194	$ 114	$ 833	$ 1
Agricultural	266	266		267	10
Real estate construction	1,662	1,662	185	1,722	
Real estate commercial	2,729	3,167	282	2,991	4
Real estate residential	2,473	2,491	94	2,452	49
Equity Lines of Credit	633	633	149	644	
Auto	140	140		73	
Other	4	4			
Total	$ 8,854	$ 9,557	$ 824	$ 8,982	$ 64

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
As of December 31, 2013:					
With no related allowance recorded:					
Commercial	$ 1,224	$ 1,493		$ 1,239	$ 3
Agricultural	267	267		267	20
Real estate construction	1,325	1,325		1,384	79
Real estate commercial	2,237	2,675		2,489	53
Real estate residential	2,024	2,035		2,057	89
Equity Lines of Credit	339	339		294	9

Auto	77	77		20	3
Other					
With an allowance recorded:					
Commercial	$ 100	$ 100	$ 79	$ 58	$
Agricultural					
Real estate construction	412	412	13	417	25
Real estate commercial	837	837	232	994	
Real estate residential	451	451	200	452	10
Equity Lines of Credit	522	522	105	511	7
Auto					
Other					
Total:					
Commercial	$ 1,324	$ 1,593	$ 79	$ 1,297	$ 3
Agricultural	267	267		267	20
Real estate construction	1,737	1,737	13	1,801	104
Real estate commercial	3,074	3,512	232	3,483	53
Real estate residential	2,475	2,486	200	2,509	99
Equity Lines of Credit	861	861	105	805	16
Auto	77	77		20	3
Other					
Total	$ 9,815	$ 10,533	$ 629	$ 10,182	$ 298

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 $85,804,000 and $84,229,000 and stand-by letters of credit of $50,000 and $60,000 at June 30, 2014 and December 31, 2013, respectively.

Of the loan commitments outstanding at June 30, 2014, $12,004,000 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 June 30, 2014 or December 31, 2013.

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.

(In thousands, except per share data)	For the Three Months Ended June 30, 2014	For the Three Months Ended June 30, 2013	For the Six Months Ended June 30, 2014	For the Six Months Ended June 30, 2013
Net Income:				
Net income	$ 1,125	$ 891	$ 2,067	$ 1,507
Discount on redemption of preferred stock		530		530
Dividends and discount accretion on preferred shares		(110)		(281)
Net income available to common shareholders	$ 1,125	$ 1,311	$ 2,067	$ 1,756
Earnings Per Share:				
Basic earnings per share	$ 0.23	$ 0.27	$ 0.43	$ 0.37
Diluted earnings per share	$ 0.23	$ 0.27	$ 0.42	$ 0.36
Weighted Average Number of Shares Outstanding:				
Basic shares	4,792	4,779	4,790	4,778
Diluted shares	4,958	4,862	4,944	4,842

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 267,000 and 200,000 for the three month periods ended June 30, 2014 and 2013, respectively. 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 267,000 and 320,000 for the six month periods ended June 30, 2014 and 2013, respectively.

8. STOCK-BASED COMPENSATION

Stock Options

In 2001, the Company established a Stock Option Plan (the 2001 Plan) for which 339,209 shares of common stock remain reserved for issuance to employees and directors and no shares are available for future grants as of June 30, 2014.

A summary of the activity within the 2001 Plan follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term in Years	Intrinsic Value
Options outstanding at January 1, 2014	365,059	$ 8.53		
Options cancelled	(18,450)	12.77		
Options exercised	(7,400)	2.95		
Options outstanding at June 30, 2014	339,209	$ 8.42	3.0	$ 703,780
Options exercisable at June 30, 2014	290,016	$ 9.35	2.7	$ 514,360
Expected to vest after June 30, 2014	41,918	$ 2.95	4.7	$ 161,386

Compensation cost related to stock options recognized in operating results under the 2001 Plan was $24,000 and $19,000 for the six months ended June 30, 2014 and 2013, respectively. The associated future income tax benefit recognized was $1,000 for the six months ended June 30, 2014 and 2013. Compensation cost related to stock options recognized in operating results was $14,000 and $10,000 for the quarters ended June 30, 2014 and 2013. There was no associated future income tax benefit recognized for the quarters ended June 30, 2014 and 2013.

At June 30, 2014, there was $30,000 of total unrecognized compensation cost related to non-vested stock option awards which is expected to be recognized over a weighted-average period of 1 year.

The total fair value of options vested during the six months ended June 30, 2014 was $49,000. The total intrinsic value of options exercised during the six months ended June 30, 2014 was $30,000.

Cash received for options exercised during the six months ended June 30, 2014 was $22,000. The tax benefit realized for the tax deductions from option exercise totaled $8,000 and $0, respectively, for the six months ended June 30, 2014 and 2013.

In May 2013, the Company established the 2013 Stock Option Plan (the 2013 Plan) for which 500,000 shares of common stock are reserved and 389,600 shares are available for future grants as of June 30, 2014. 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, with Company common stock previously acquired by the optionee and held by the optionee for a period of at least six months, in options of the Optionee that are fully vested and exercisable or in any combination of the foregoing. The options expire on dates determined by the Board of Directors, but not later than ten years from the date of grant.

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The fair value of each option is estimated on the date of grant using the following assumptions in 2014.

	Six Months Ended June 30, 2014
Expected life of stock options	5.2 years
Interest rate stock options	1.64%
Volatility stock options	63.8%
Dividend yields	2.0%
Weighted-average fair value of options granted during the period	$ 3.02

A summary of the activity within the 2013 Plan follows:

	Shares	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Term in Years**	**Intrinsic Value**
Options outstanding at January 1, 2014		$		
Options granted	110,400	6.32		
Options outstanding at June 30, 2014	110,400	$ 6.32	7.8	$ 52,992