

MIDDLEFIELD BANC CORP

Form 10-Q

August 11, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20552

FORM 10 - Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2015

Commission File Number 001-36613

Middlefield Banc Corp.

(Exact name of registrant as specified in its charter)

Ohio

(State or other jurisdiction of incorporation or organization)

34 - 1585111

(IRS Employer Identification No.)

15985 East High Street, Middlefield, Ohio 44062-9263

(Address of principal executive offices)

(440) 632-1666

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

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

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

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

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

YES NO

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

Class: Common Stock, without par value

Outstanding at August 11, 2015: 2,062,733

MIDDLEFIELD BANC CORP.

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MIDDLEFIELD BANC CORP.

CONSOLIDATED BALANCE SHEET

(Dollar amounts in thousands, except share data)

(Unaudited)

	June 30, 2015	December 31, 2014
ASSETS		
Cash and due from banks	\$20,311	\$20,846
Federal funds sold	2,340	4,793
Cash and cash equivalents	22,651	25,639
Investment securities available for sale, at fair value	157,577	154,334
Loans held for sale	398	438
Loans	492,893	470,584
Less allowance for loan and lease losses	6,346	6,846
Net loans	486,547	463,738
Premises and equipment, net	10,019	9,980
Goodwill	4,559	4,559
Core deposit intangibles	96	116
Bank-owned life insurance	13,253	9,092
Other real estate owned	2,308	2,590
Accrued interest and other assets	8,110	7,045
TOTAL ASSETS	\$705,518	677,531
LIABILITIES		
Deposits:		
Noninterest-bearing demand	\$109,732	\$105,512
Interest-bearing demand	59,128	56,377
Money market	73,425	75,895
Savings	179,353	178,470
Time	201,886	169,858
Total deposits	623,524	586,112
Short-term borrowings	4,517	14,808
Other borrowings	10,465	10,624
Accrued interest and other liabilities	2,200	2,120
TOTAL LIABILITIES	640,706	613,664
STOCKHOLDERS' EQUITY		

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Common stock, no par value; 10,000,000 shares authorized, 2,252,179 and 2,242,025 shares issued; 2,062,649 and 2,052,495 shares outstanding	35,854	35,529
Retained earnings	34,570	32,524
Accumulated other comprehensive income	1,122	2,548
Treasury stock, at cost; 189,530 shares	(6,734)	(6,734)
TOTAL STOCKHOLDERS' EQUITY	64,812	63,867
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$705,518	\$677,531

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF INCOME

(Dollar amounts in thousands, except per share data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
INTEREST INCOME				
Interest and fees on loans	\$5,842	\$5,575	\$11,685	\$11,269
Interest-bearing deposits in other institutions	12	9	20	14
Federal funds sold	5	6	8	9
Investment securities:				
Taxable interest	379	526	774	1,035
Tax-exempt interest	805	783	1,564	1,538
Dividends on stock	23	20	50	43
Total interest income	7,066	6,919	14,101	13,908
INTEREST EXPENSE				
Deposits	874	929	1,705	1,869
Short-term borrowings	33	38	70	73
Other borrowings	23	32	46	64
Trust preferred securities	60	34	52	60
Total interest expense	990	1,033	1,873	2,066
NET INTEREST INCOME	6,076	5,886	12,228	11,842
Provision for loan losses	-	120	105	300
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	6,076	5,766	12,123	11,542
NONINTEREST INCOME				
Service charges on deposit accounts	470	469	911	910
Investment securities gains, net	22	64	46	58
Earnings on bank-owned life insurance	92	68	161	135
Gain on sale of loans	120	-	173	-
Other income	258	256	467	469
Total noninterest income	962	857	1,758	1,572
NONINTEREST EXPENSE				

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Salaries and employee benefits	2,560	2,268	4,920	4,284
Occupancy expense	291	275	640	596
Equipment expense	241	194	457	414
Data processing costs	261	224	511	438
Ohio state franchise tax	75	93	150	176
Federal deposit insurance expense	120	97	232	229
Professional fees	277	338	596	625
(Gain) loss on other real estate owned	(40)	75	48	70
Advertising expense	195	124	391	247
Other real estate expense	268	102	333	165
Directors fees	127	118	245	204
Other expense	842	690	1,505	1,379
Total noninterest expense	5,217	4,598	10,028	8,827
Income before income taxes	1,821	2,025	3,853	4,287
Income taxes	316	414	720	913
NET INCOME	\$1,505	\$1,611	\$3,133	\$3,374
EARNINGS PER SHARE				
Basic	\$0.73	\$0.79	\$1.52	\$1.66
Diluted	0.73	0.79	1.52	1.65
DIVIDENDS DECLARED PER SHARE	\$0.27	\$0.26	\$0.53	\$0.52

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(Dollar amounts in thousands)

(Unaudited)

	Three Months Ended June 30, 2015		Six Months Ended June 30, 2014	
Net income	\$1,505	\$1,611	\$3,133	\$3,374
Other comprehensive (loss) income:				
Net unrealized holding (loss) gain on available-for-sale securities	(2,966)	1,950	(2,115)	4,749
Tax effect	1,008	(663)	719	(1,615)
Reclassification adjustment for investment securities gain included in net income	(22)	(64)	(46)	(58)
Tax effect	8	22	16	20
Total other comprehensive (loss) income	(1,972)	1,245	(1,426)	3,096
Comprehensive (loss) income	\$(467)	\$2,856	\$1,707	\$6,470

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

(Dollar amounts in thousands, except share data)

(Unaudited)

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2014	\$ 35,529	\$ 32,524	\$ 2,548	\$ (6,734)	\$ 63,867
Net income		3,133			3,133
Other comprehensive loss			(1,426)		(1,426)
Dividend reinvestment and purchase plan (9,754 shares)	319				319
Stock options exercised (400 shares)	6				6
Cash dividends (\$0.53 per share)		(1,087)			(1,087)
Balance, June 30, 2015	\$ 35,854	\$ 34,570	\$ 1,122	\$ (6,734)	\$ 64,812

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF CASH FLOWS

(Dollar amounts in thousands)

(Unaudited)

	Six Months Ended June 30,	
	2015	2014
OPERATING ACTIVITIES		
Net income	\$3,133	\$3,374
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Provision for loan losses	105	300
Investment securities gain, net	(46)	(58)
Depreciation and amortization	500	373
Amortization of premium and discount on investment securities	365	370
Accretion of deferred loan fees, net	(346)	(141)
Origination of loans held for sale	(8,026)	-
Proceeds from sale of loans	8,239	-
Gain on sale of loans	(173)	-
Earnings on bank-owned life insurance	(161)	(135)
Deferred income tax	346	(262)
Loss on other real estate owned	48	70
Increase in accrued interest receivable	(157)	(94)
Increase (decrease) in accrued interest payable	74	(22)
Other, net	(573)	(797)
Net cash provided by operating activities	3,328	2,978
INVESTING ACTIVITIES		
Investment securities available for sale:		
Proceeds from repayments and maturities	5,818	6,809
Proceeds from sale of securities	3,312	1,494
Purchases	(14,876)	(12,287)
Increase in loans, net	(23,206)	(14,490)
Proceeds from the sale of other real estate owned	830	256
Purchase of bank-owned life insurance	(4,000)	-
Purchase of premises and equipment	(394)	(444)
Net cash used for investing activities	(32,516)	(18,662)
FINANCING ACTIVITIES		
Net increase in deposits	37,412	19,957
Decrease in short-term borrowings, net	(10,291)	(3,870)

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Repayment of other borrowings	(159)	(247)
Stock options exercised	6	-
Proceeds from dividend reinvestment and purchase plan	319	287
Cash dividends	(1,087)	(1,059)
Net cash provided by financing activities	26,200	15,068
Decrease in cash and cash equivalents	(2,988)	(616)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	25,639	26,193
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$22,651	\$25,577
SUPPLEMENTAL INFORMATION		
Cash paid during the year for:		
Interest on deposits and borrowings	\$1,799	\$2,088
Income taxes	200	1,395
Noncash investing transactions:		
Transfers from loans to other real estate owned	\$638	\$20

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

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

The accompanying unaudited financial statements have been prepared in accordance with U.S. generally accepted accounting principles and the instructions for Form 10-Q and Article 10 of Regulation S-X. In management's opinion, the financial statements include all adjustments, consisting of normal recurring adjustments, that the Company considers necessary to fairly state the Company's financial position and the results of operations and cash flows. The consolidated balance sheet at December 31, 2014, has been derived from the audited financial statements at that date but does not include all of the necessary informational disclosures and footnotes as required by U.S. generally accepted accounting principles. The accompanying financial statements should be read in conjunction with the financial statements and notes thereto included with the Company's Form 10-K for the year ended December 31, 2014. The results of the Company's operations for any interim period are not necessarily indicative of the results of the Company's operations for any other interim period or for a full fiscal year.

Recent Accounting Pronouncements

In January 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-01, *Investments – Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects*. The amendments in this Update permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments in this Update should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this Update are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. This Update did not have a significant impact on the Company's financial statements.

In January 2014, the FASB issued ASU 2014-04, *Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. The amendments in this Update clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this Update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in this Update using either a modified retrospective transition method or a prospective transition method. The Company has included the disclosures related to this Update in Note 8.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers* (a new revenue recognition standard). The Update's core principle is that a company will recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, this update specifies the accounting for certain costs to obtain or fulfill a contract with a customer and expands disclosure requirements for revenue recognition. This Update is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The Company is evaluating the effect of adopting this new accounting Update.

In June 2014, the FASB issued ASU 2014-11, *Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*. The amendments in this Update change the accounting for repurchase-to-maturity transactions to secured borrowing accounting. For repurchase financing arrangements, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, which will result in secured borrowing accounting for the repurchase agreement. The amendments also require enhanced disclosures. The accounting changes in this Update are effective for the first interim or annual period beginning after December 15, 2014. An entity is required to present changes in accounting for transactions outstanding on the effective date as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. Earlier application is prohibited. The disclosure for certain transactions accounted for as a sale is required to be presented for interim and annual periods beginning after December 15, 2014, and the disclosure for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and for interim periods beginning after March 15, 2015. The disclosures are not required to be presented for comparative periods before the effective date. This Update did not have a significant impact on the Company's financial statements.

In June 2014, the FASB issued ASU 2014-12, *Compensation-Stock Compensation (Topic 718): Accounting for Share-Based Payments when the Terms of an Award Provide that a Performance Target Could Be Achieved After the Requisite Service Period*. The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. The amendments in this Update are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. Entities may apply the amendments in this Update either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. If retrospective transition is adopted, the cumulative effect of applying this Update as of the beginning of the earliest annual period presented in the financial statements should be recognized as an adjustment to the opening retained earnings balance at that date. Additionally, if retrospective transition is adopted, an entity may use hindsight in measuring and recognizing the compensation cost. This Update is not expected to have a significant impact on the Company's financial statements.

In August 2014, the FASB issued ASU 2014-14, *Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40)*. The amendments in this Update require that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met: (1) the loan has a government guarantee that is not separable from the loan before foreclosure, (2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim, and (3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The amendments in this Update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. This Update did not have a significant impact on the Company's financial statements.

In August 2014, the FASB issued ASU 2014-15, *Presentation of Financial Statements -Going Concern (Subtopic 205-40)*. The amendments in this Update provide guidance in accounting principles generally accepted in the United States of America about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The amendments in this Update are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. This Update is not expected to have a significant impact on the Company's financial statements.

In November 2014, the FASB issued ASU 2014-16, *Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity (a consensus of the FASB Emerging Issues Task Force)*. This ASU clarifies how current U.S. GAAP should be interpreted in subjectively evaluating the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share. Public business entities are required to implement the new requirements in fiscal years and interim periods within those fiscal years beginning after December 15, 2015. This Update is not expected to have a significant impact on the Company's financial statements.

In November 2014, the FASB issued ASU 2014-17, *Business Combinations (Topic 805): Pushdown Accounting*. The amendments in this Update apply to the separate financial statements of an acquired entity and its subsidiaries that are a business or nonprofit activity (either public or nonpublic) upon the occurrence of an event in which an acquirer (an individual or an entity) obtains control of the acquired entity. An acquired entity may elect the option to apply pushdown accounting in the reporting period in which the change-in-control event occurs. If pushdown accounting is not applied in the reporting period in which the change-in-control event occurs, an acquired entity will have the option to elect to apply pushdown accounting in a subsequent reporting period to the acquired entity's most recent change-in-control event. The amendments in this Update are effective on November 18, 2014. After the effective date, an acquired entity can make an election to apply the guidance to future change-in-control events or to its most recent change-in-control event. This Update is not expected to have a significant impact on the Company's financial statements.

In January 2015, the FASB issued ASU 2015-01, *Income Statement –Extraordinary and Unusual Items*, as part of its initiative to reduce complexity in accounting standards. This Update eliminates from GAAP the concept of extraordinary items. The amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. A reporting entity may apply the amendments prospectively. A reporting entity also may apply the amendments retrospectively to all prior periods presented in the financial statements. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. This Update is not expected to have a significant impact on the Company's financial statements.

In February 2015, the FASB issued ASU 2015-02, *Consolidation (Topic 810)*. The amendments in this Update affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. Specifically, the amendments (1) Modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities; (2) Eliminate the presumption that a general partner should consolidate a limited partnership; (3) Affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships; (4) Provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. The amendments in this Update are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2016, and for interim periods within fiscal years beginning after December 15, 2017. This Update is not expected to have a significant impact on the Company's financial statements.

In April 2015, the FASB issued ASU 2015-03, *Interest-Imputation of Interest (Subtopic 835-30)*, as part of its initiative to reduce complexity in accounting standards. To simplify presentation of debt issuance costs, the amendments in this Update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this Update. For public business entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016. An entity should apply the new guidance on a retrospective basis, wherein the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. This Update is not expected to have a significant impact on the Company's financial statements.

In April 2015, the FASB issued ASU 2015-04, *Compensation-Retirement Benefits (Topic 715)*, as part of its initiative to reduce complexity in accounting standards. For an entity with a fiscal year-end that does not coincide with a month-end, the amendments in this Update provide a practical expedient that permits the entity to measure defined benefit plan assets and obligations using the month-end that is closest to the entity's fiscal year-end and apply that practical expedient consistently from year to year. The practical expedient should be applied consistently to all plans if an entity has more than one plan. The amendments in this Update are effective for public business entities for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. Earlier application is permitted. This Update is not expected to have a significant impact on the Company's financial statements.

In April 2015, the FASB issued ASU 2015-05, *Intangible – Goodwill and Other Internal Use Software (Topic 350-40)*, as part of its initiative to reduce complexity in accounting standards. This guidance will help entities evaluate

the accounting for fees paid by a customer in a cloud computing arrangement. The amendments in this Update provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. For public business entities, the Board decided that the amendments will be effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. For all other entities, the amendments will be effective for annual periods beginning after December 15, 2015, and interim periods in annual periods beginning after December 15, 2016. Early adoption is permitted for all entities. This Update is not expected to have a significant impact on the Company's financial statements.

In April 2015, the FASB issued ASU 2015-06, Earnings Per Share (Topic 260): Effects on Historical Earnings per Unit of Master Limited Partnership Dropdown Transactions. Topic 260, Earnings Per Share, contains guidance that addresses master limited partnerships that originated from Emerging Issues Task Force ("EITF") Issue No. 07-4, Application of the Two-Class Method Under FASB Statement No. 128 to Master Limited Partnerships. Under Topic 260, master limited partnerships apply the two-class method of calculating earnings per unit because the general partner, limited partners, and incentive distribution rights holders each participate differently in the distribution of available cash in accordance with the contractual rights contained in the partnership agreement. The amendments in this Update specify that for purposes of calculating historical earnings per unit under the two-class method, the earnings (losses) of a transferred business before the date of a dropdown transaction should be allocated entirely to the general partner. In that circumstance, the previously reported earnings per unit of the limited partners (which is typically the earnings per unit measure presented in the financial statements) would not change as a result of the dropdown transaction. Qualitative disclosures about how the rights to the earnings (losses) differ before and after the dropdown transaction occurs for purposes of computing earnings per unit under the two-class method are also required. The amendments in this Update are effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Earlier application is permitted. This Update is not expected to have a significant impact on the Company's financial statements.

In May 2015, the FASB issued ASU 2015-07, Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent). The Update applies to reporting entities that elect to measure the fair value of an investment using the net asset value per share (or its equivalent) practical expedient. Under the amendments in this Update, investments for which fair value is measured at net asset value per share (or its equivalent) using the practical expedient should not be categorized in the fair value hierarchy. Removing those investments from the fair value hierarchy not only eliminates the diversity in practice resulting from the way in which investments measured at net asset value per share (or its equivalent) with future redemption dates are classified, but also ensures that all investments categorized in the fair value hierarchy are classified using a consistent approach. Investments that calculate net asset value per share (or its equivalent), but for which the practical expedient is not applied will continue to be included in the fair value hierarchy. A reporting entity should continue to disclose information on investments for which fair value is measured at net asset value (or its equivalent) as a practical expedient to help users understand the nature and risks of the investments and whether the investments, if sold, are probable of being sold at amounts different from net asset value. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. A reporting entity should apply the amendments retrospectively to all periods presented. The retrospective approach requires that an investment for which fair value is measured using the net asset value per share practical expedient be removed from the fair value hierarchy in all periods presented in an entity's financial statements. Earlier application is permitted. This Update is not expected to have a significant impact on the Company's financial statements.

In May 2015, the FASB issued ASU 2015-08, Business Combinations – Pushdown Accounting – Amendment to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115. This Update was issued to amend various SEC paragraphs pursuant to the issuance of Staff Accounting Bulletin No. 115. This Update is not expected to have a significant impact on the Company's financial statements.

In May 2015, the FASB issued ASU 2015-09, Financial Services – Insurance (Topic 944): Disclosure About Short-Duration Contracts. The amendments apply to all insurance entities that issue short-duration contracts as defined in Topic 944, Financial Services – Insurance. The amendments require insurance entities to disclose for annual reporting periods certain information about the liability for unpaid claims and claim adjustment expenses. The amendments also require insurance entities to disclose information about significant changes in methodologies and assumptions used to calculate the liability for unpaid claims and claim adjustment expenses, including reasons for the change and the effects on the financial statements. Additionally, the amendments require insurance entities to disclose for annual and interim reporting periods a rollforward of the liability for unpaid claims and claim adjustment expenses, described in Topic 944. For health insurance claims, the amendments require the disclosure of the total of incurred-but-not-reported liabilities plus expected development on reported claims included in the liability for unpaid claims and claim adjustment expenses. For public business entities, the amendments in this Update are effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016. For all other entities, the amendments in this Update are effective for annual periods beginning after December 15, 2016, and interim periods within annual periods beginning after December 15, 2017. This Update is not expected to have a significant impact on the Company's financial statements.

In June 2015, the FASB issued ASU 2015-10, Technical Corrections and Improvements. The amendments in this Update represent changes to clarify the FASB Accounting Standards Codification (“Codification”), correct unintended application of guidance, or make minor improvements to the Codification that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities. Transition guidance varies based on the amendments in this Update. The amendments in this Update that require transition guidance are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. All other amendments will be effective upon the issuance of this Update. This Update is not expected to have a significant impact on the Company’s financial statements.

NOTE 2 - STOCK-BASED COMPENSATION

The Company had no unvested stock options outstanding or unrecognized stock-based compensation costs outstanding as of June 30, 2015 and 2014.

Stock option activity during the six months ended June 30 is as follows:

	2015	Weighted- average Exercise Price	2014	Weighted- average Exercise Price
Outstanding, January 1	46,451	\$ 27.90	58,581	\$ 28.38
Expired	(3,639)	37.33	(907)	27.35
Exercised	(525)	17.55	-	-
Outstanding, June 30	42,287	\$ 27.19	57,674	\$ 28.40
Exercisable, June 30	42,287	\$ 27.19	57,674	\$ 28.40

NOTE 3 - EARNINGS PER SHARE

The Company provides dual presentation of basic and diluted earnings per share. Basic earnings per share is calculated by dividing net income by the average shares outstanding. Diluted earnings per share adds the dilutive effects of stock options to average shares outstanding.

The following table sets forth the composition of the weighted-average common shares (denominator) used in the basic and diluted earnings per share computation.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
Weighted-average common shares outstanding	2,248,516	2,227,556	2,245,868	2,225,555

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Average treasury stock shares	(189,530)	(189,530)	(189,530)	(189,530)
Weighted-average common shares and common stock equivalents used to calculate basic earnings per share	2,058,986	2,038,026	2,056,338	2,036,025
Additional common stock equivalents (stock options) used to calculate diluted earnings per share	9,327	6,538	9,590	6,156
Weighted-average common shares and common stock equivalents used to calculate diluted earnings per share	2,068,313	2,044,564	2,065,928	2,042,181

Options to purchase 42,437 shares of common stock, at prices ranging from \$17.55 to \$37.48, were outstanding during the three and six months ended June 30, 2015. Of those options, 27,000 were considered dilutive for the three month period based on the market price exceeding the strike price. For the six months ended June 30, 2015, 27,250 options were considered dilutive.

Options to purchase 57,674 shares of common stock, at prices ranging from \$17.55 to \$40.24, were outstanding during the three and six months ended June 30, 2014. Of those options, 28,282 were considered dilutive for both periods based on the market price exceeding the strike price.

NOTE 4 - FAIR VALUE MEASUREMENTS

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

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

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

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

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

(Dollar amounts in thousands)	June 30, 2015			Total
	Level I	Level II	Level III	
Assets measured on a recurring basis:				

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U.S. government agency securities	\$ -	\$22,222	\$ -	\$22,222
Obligations of states and political subdivisions	-	105,059	-	105,059
Mortgage-backed securities in government- sponsored entities		26,682		26,682
Private-label mortgage-backed securities	-	2,715	-	2,715
Total debt securities	-	156,678	-	156,678
Equity securities in financial institutions	5	894	-	899
Total	\$ 5	\$157,572	\$ -	\$157,577

(Dollar amounts in thousands)	December 31, 2014			Total
	Level I	Level II	Level III	
Assets measured on a recurring basis:				
U.S. government agency securities	\$ -	\$22,896	\$ -	\$22,896
Obligations of states and political subdivisions	-	98,345	-	98,345
Mortgage-backed securities in government- sponsored entities	-	29,391	-	29,391
Private-label mortgage-backed securities	-	2,919	-	2,919
Total debt securities	-	153,551	-	153,551
Equity securities in financial institutions	5	778	-	783
Total	\$ 5	\$154,329	\$ -	\$154,334

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

Financial instruments are considered Level III when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. In addition to these unobservable inputs, the valuation models for Level III financial instruments typically also rely on a number of inputs that are readily observable either directly or indirectly. Level III financial instruments also include those for which the determination of fair value requires significant management judgment or estimation. The Company has no securities considered to be Level III as of June 30, 2015 or December 31, 2014.

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

The following tables present the assets measured on a nonrecurring basis on the Consolidated Balance Sheet at their fair value by level within the fair value hierarchy. Impaired loans that are collateral dependent are written down to fair value through the establishment of specific reserves. Techniques used to value the collateral that secure the impaired loan include quoted market prices for identical assets classified as Level I inputs and observable inputs, employed by certified appraisers, for similar assets classified as Level II inputs. In cases where valuation techniques included inputs that are unobservable and are based on estimates and assumptions developed by management based on the best information available under each circumstance, the asset valuation is classified as Level III inputs. The Company values other real estate owned at the estimated fair value of the underlying collateral less expected selling costs. Such values are estimated primarily using appraisals and reflect a market value approach. Due to the significance of the Level III inputs, other real estate owned has been classified as Level III.

June
30,
2015

(Dollar amounts in thousands)