AMERISERV FINANCIAL INC /PA/
Form 10-Q
August 12, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the period ended June 30, 2011

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

Commission File Number 0-11204

AmeriServ Financial, Inc.

(Exact name of registrant as specified in its charter)

Pennsylvania	**25-1424278**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
Main & Franklin Streets, P.O. Box 430, Johnstown, PA	**15907-0430**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code (814) 533-5300

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

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

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	**Outstanding at August 1, 2011**
Common Stock, par value $0.01	**21,208,421**

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Item 1. Financial Statements

AmeriServ Financial, Inc.

CONSOLIDATED BALANCE SHEETS

(In thousands)

(Unaudited)

	June 30, 2011	December 31, 2010
ASSETS		
Cash and due from depository institutions	$ 18,389	$ 14,160
Interest bearing deposits	1,721	1,716
Short-term investments in money market funds	2,617	3,461
Cash and cash equivalents	22,727	19,337
Investment securities:		
Available for sale	189,661	164,811
Held to maturity (fair value $9,568 on June 30, 2011 and $8,267 on December 31, 2010)	9,109	7,824
Loans held for sale	2,486	7,405
Loans	654,734	671,253
Less: Unearned income	382	477
Allowance for loan losses	16,958	19,765
Net loans	637,394	651,011
Premises and equipment, net	10,545	10,485
Accrued income receivable	3,671	3,210
Goodwill	12,613	12,950
Bank owned life insurance	34,901	34,466
Net deferred tax asset	13,853	16,058
Federal Home Loan Bank stock	6,528	7,233
Federal Reserve Bank stock	2,125	2,125
Prepaid federal deposit insurance	2,201	3,073
Other assets	7,079	8,986
TOTAL ASSETS	$ 954,893	$ 948,974
LIABILITIES		
Non-interest bearing deposits	$ 131,464	$ 127,870
Interest bearing deposits	678,618	673,346
Total deposits	810,082	801,216
Short-term borrowings		4,550
Advances from Federal Home Loan Bank	9,722	9,750
Guaranteed junior subordinated deferrable interest debentures	13,085	13,085
Total borrowed funds	22,807	27,385
Other liabilities	10,594	13,315

TOTAL LIABILITIES		843,483		841,916
SHAREHOLDERS EQUITY				
Preferred stock, no par value; $1,000 per share liquidation preference; 2,000,000 shares authorized; 21,000 shares issued and outstanding on June 30, 2011 and December 31, 2010.		20,724		20,669
Common stock, par value $0.01 per share; 30,000,000 shares authorized; 26,397,040 shares issued and 21,208,421 outstanding on June 30, 2011; 26,396,289 shares issued and 21,207,670 outstanding on December 31, 2010		264		264
Treasury stock at cost, 5,188,619 shares on June 30, 2011 and December 31, 2010		(68,659)		(68,659)
Capital surplus		145,056		145,045
Retained earnings		17,222		14,601
Accumulated other comprehensive loss, net		(3,197)		(4,862)
TOTAL SHAREHOLDERS EQUITY		111,410		107,058
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$	954,893	$	948,974

See accompanying notes to unaudited consolidated financial statements.

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AmeriServ Financial, Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands)

(Unaudited)

	Three months ended		Six months ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
INTEREST INCOME				
Interest and fees on loans	$ 8,804	$ 9,984	$ 17,887	$ 20,004
Interest bearing deposits				1
Short-term investments in money market funds	2	4	5	7
Federal funds sold	3	1	7	2
Investment securities:				
Available for sale	1,617	1,353	3,028	2,675
Held to maturity	104	108	199	226
Total Interest Income	10,530	11,450	21,126	22,915
INTEREST EXPENSE				
Deposits	2,106	2,833	4,400	5,760
Short-term borrowings	1	4	2	13
Advances from Federal Home Loan Bank	57	125	112	253
Guaranteed junior subordinated deferrable interest debentures	280	280	560	560
Total Interest Expense	2,444	3,242	5,074	6,586
NET INTEREST INCOME	8,086	8,208	16,052	16,329
Provision (credit) for loan losses	(1,175)	1,200	(1,775)	4,250
NET INTEREST INCOME AFTER PROVISION (CREDIT) FOR LOAN LOSSES	9,261	7,008	17,827	12,079
NON-INTEREST INCOME				
Trust fees	1,617	1,373	3,173	2,827
Investment advisory fees	198	167	396	354
Net realized (losses) gains on investment securities		42	(358)	107
Net gains on loans held for sale	155	159	417	290
Service charges on deposit accounts	549	611	1,021	1,183
Bank owned life insurance	218	258	435	512
Other income	717	778	1,475	1,415
Total Non-Interest Income	3,454	3,388	6,559	6,688
NON-INTEREST EXPENSE				
Salaries and employee benefits	5,574	5,236	11,074	10,435
Net occupancy expense	742	639	1,499	1,375
Equipment expense	411	427	840	845

Professional fees	911	1,114	1,891	2,216
Supplies, postage and freight	220	257	459	541
Miscellaneous taxes and insurance	331	353	680	707
Federal deposit insurance expense	460	341	922	672
Other expense	1,228	1,419	2,431	2,759
Total Non-Interest Expense	9,877	9,786	19,796	19,550
PRETAX INCOME (LOSS)	2,838	610	4,590	(783)
Provision for income tax expense (benefit)	900	133	1,389	(342)
NET INCOME (LOSS)	1,938	477	3,201	(441)
Preferred stock dividends and accretion of preferred stock discount	290	290	580	581
NET INCOME (LOSS) AVAILABLE TO COMMON SHAREHOLDERS	$ 1,648	$ 187	$ 2,621	$ (1,022)
PER COMMON SHARE DATA:				
Basic:				
Net income (loss)	$ 0.08	$ 0.01	$ 0.12	$ (0.05)
Average number of shares outstanding	21,208	21,224	21,208	21,224
Diluted:				
Net income (loss)	$ 0.08	$ 0.01	$ 0.12	$ (0.05)
Average number of shares outstanding	21,236	21,245	21,233	21,231
Cash dividends declared	$ 0.00	$ 0.00	$ 0.00	$ 0.00

See accompanying notes to unaudited consolidated financial statements.

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AmeriServ Financial, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six months ended	
	June 30, 2011	June 30, 2010
OPERATING ACTIVITIES		
Net income (loss)	$ 3,201	$ (441)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Provision (credit) for loan losses	(1,775)	4,250
Depreciation expense	743	739
Net amortization of investment securities	301	135
Net realized losses (gains) on investment securities available for sale	358	(107)
Net gains on loans held for sale	(417)	(290)
Amortization of deferred loan fees	(134)	(224)
Origination of mortgage loans held for sale	(23,964)	(26,507)
Sales of mortgage loans held for sale	29,300	25,514
Increase in accrued interest income receivable	(461)	(114)
Decrease in accrued interest expense payable	(976)	(1,033)
Earnings on bank owned life insurance	(435)	(512)
Deferred income taxes	2,205	514
Stock based compensation expense	11	39
Decrease in prepaid Federal Deposit Insurance	872	622
Net decrease (increase) in other assets	3,141	(2,283)
Net (decrease) increase in other liabilities	(1,745)	409
Net cash provided by operating activities	10,225	711
INVESTING ACTIVITIES		
Purchases of investment securities - available for sale	(63,412)	(40,890)
Purchases of investment securities - held to maturity	(1,991)	(1,123)
Proceeds from sales of investment securities available for sale	16,518	1,801
Proceeds from maturities of investment securities available for sale	22,693	27,559
Proceeds from maturities of investment securities held to maturity	710	3,769
Proceeds from redemption of regulatory stock	705	
Long-term loans originated	(58,217)	(36,714)
Principal collected on long-term loans	77,660	65,574
Loans purchased or participated	(3,500)	(1,345)
Sale of other real estate owned	588	721
Purchases of premises and equipment	(803)	(1,932)
Net cash (used in) provided by investing activities	(9,049)	17,420
FINANCING ACTIVITIES		
Net increase in deposit accounts	7,317	23,572
Net decrease in other short-term borrowings	(4,550)	(25,775)
Principal borrowings on advances from Federal Home Loan Bank		34,000
Principal repayments on advances from Federal Home Loan Bank	(28)	(42,026)
Preferred stock dividends	(525)	(525)

Net cash provided by (used in) financing activities	2,214	(10,754)
NET INCREASE IN CASH AND CASH EQUIVALENTS	3,390	7,377
CASH AND CASH EQUIVALENTS AT JANUARY 1	19,337	26,308
CASH AND CASH EQUIVALENTS AT JUNE 30	$ 22,727	$ 33,685

See accompanying notes to unaudited consolidated financial statements.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. **Principles of Consolidation**

The accompanying consolidated financial statements include the accounts of AmeriServ Financial, Inc. (the Company) and its wholly-owned subsidiaries, AmeriServ Financial Bank (Bank), AmeriServ Trust and Financial Services Company (Trust Company), and AmeriServ Life Insurance Company (AmeriServ Life). The Bank is a state-chartered full service bank with 18 locations in Pennsylvania. The Trust Company offers a complete range of trust and financial services and administers assets valued at $1.4 billion that are not recognized on the Company s balance sheet at June 30, 2011. AmeriServ Life is a captive insurance company that engages in underwriting as a reinsurer of credit life and disability insurance.

In addition, the Parent Company is an administrative group that provides support in such areas as audit, finance, investments, loan review, general services, and marketing. Significant intercompany accounts and transactions have been eliminated in preparing the consolidated financial statements.

2. **Basis of Preparation**

The unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. In the opinion of management, all adjustments consisting only of normal recurring entries considered necessary for a fair presentation have been included. They are not, however, necessarily indicative of the results of consolidated operations for a full-year.

For further information, refer to the consolidated financial statements and accompanying notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

3. **Accounting Policies**

In April 2011, the FASB issued ASU 2011-02, *Receivables (Topic 310): A Creditor s Determination of Whether a Restructuring Is a Troubled Debt Restructuring*. The amendments in this Update provide additional guidance or clarification to help creditors in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring constitutes a troubled debt restructuring. The amendments in this Update are effective for the first interim or annual reporting period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning annual period of adoption. As a result of applying these amendments, an entity may identify receivables that are newly considered impaired. For purposes of measuring impairment of those receivables, an entity should apply the amendments prospectively for the first interim or annual period beginning on or after June 15, 2011. The Company is currently evaluating the impact the adoption of the standard will have on the Company s financial position or results of operations.

In June 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income*. The amendments in this Update improve the comparability, clarity, consistency, and transparency of financial reporting and increase the prominence of items reported in other comprehensive income. To increase the prominence of items reported in other comprehensive income and to

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facilitate convergence of U.S. GAAP and IFRS, the option to present components of other comprehensive income as part of the statement of changes in stockholders equity was eliminated. The amendments require that all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. All entities that report items of comprehensive income, in any period presented, will be affected by the changes in this Update. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. For nonpublic entities, the amendments are effective for fiscal years ending after December 15, 2012, and interim and annual periods thereafter. The amendments in this Update should be applied retrospectively, and early adoption is permitted. The Company is currently evaluating the impact the adoption of the standard will have on the Company s financial position or results of operations.

4. **Earnings Per Common Share**

Basic earnings per share include only the weighted average common shares outstanding. Diluted earnings per share include the weighted average common shares outstanding and any potentially dilutive common stock equivalent shares in the calculation. Treasury shares are treated as retired for earnings per share purposes. Options and warrants to purchase 1,478,417 common shares, at exercise prices ranging from $2.20 to $6.10, and 1,570,209 common shares, at exercise prices ranging from $1.80 to $6.10, were outstanding as of June 30, 2011 and 2010, respectively, but were not included in the computation of diluted earnings per common share because to do so would be antidilutive. Options to purchase 144,195 common shares at exercise prices ranging from $1.53 to $2.07 were outstanding as of June 30, 2011, and were included in the computation of dilutive earnings per common share. Dividends and accretion of discount on preferred shares are deducted from net income in the calculation of earnings per common share.

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
	(In thousands, except per share data)			
Numerator:				
Net income (loss)	$ 1,938	$ 477	$ 3,201	$ (441)
Preferred stock dividends and accretion of preferred stock discount	290	290	580	581
Net income (loss) available to common shareholders	$ 1,648	$ 187	$ 2,621	$ (1,022)
Denominator:				
Weighted average common shares outstanding (basic)	21,208	21,224	21,208	21,224
Effect of stock options/warrants	28	21	25	7
Weighted average common shares outstanding (diluted)	21,236	21,245	21,233	21,231
Earnings (Loss) per common share:				
Basic	$ 0.08	$ 0.01	$ 0.12	$ (0.05)
Diluted	0.08	0.01	0.12	(0.05)

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5. **Comprehensive Income**

For the Company, comprehensive income includes net income and unrealized holding gains and losses from available for sale investment securities and the pension obligation change for the defined benefit plan. The changes in other comprehensive income are reported net of income taxes, as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Net income (loss)	$ 1,938	$ 477	$ 3,201	$ (441)
Other comprehensive income, before tax:				
Pension obligation change for defined benefit plan	201	142	506	284
Income tax effect	(68)	(48)	(172)	(97)
Reclassification adjustment for (gains) losses on available for sale securities included in net (income) loss		(42)	358	(107)
Income tax effect		14	(123)	36
Unrealized holding gains on available for sale securities arising during period	2,161	2,016	1,661	2,395
Income tax effect	(735)	(685)	(565)	(814)
Other comprehensive income	1,559	1,397	1,665	1,697
Comprehensive income	$ 3,497	$ 1,874	$ 4,866	$ 1,256

6. **Consolidated Statement of Cash Flows**

On a consolidated basis, cash and cash equivalents include cash and due from depository institutions, interest-bearing deposits, federal funds sold and short-term investments in money market funds**.** The Company made $19,000 in income tax payments in the first six months of 2011 as compared to $69,000 for the first six months of 2010. The Company made total interest payments of $6,050,000 in the first six months of 2011 compared to $7,619,000 in the same 2010 period.

7. **Investment Securities**

The cost basis and fair values of investment securities are summarized as follows (in thousands):

Investment securities available for sale (AFS):

	June 30, 2011			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Agency	$ 13,821	$ 67	$ (14)	$ 13,874
U.S. Agency mortgage- backed securities	170,693	5,153	(59)	175,787
Total	$ 184,514	$ 5,220	$ (73)	$ 189,661

Investment securities held to maturity (HTM):

	June 30, 2011			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Agency mortgage- backed securities	$ 8,109	$ 465	$	$ 8,574
Other securities	1,000		(6)	994
Total	$ 9,109	$ 465	$ (6)	$ 9,568

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Investment securities available for sale (AFS):

	December 31, 2010			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Agency	$ 15,956	$ 57	$ (69)	$ 15,944
U.S. Agency mortgage-backed securities	145,727	3,714	(574)	148,867
Total	$ 161,683	$ 3,771	$ (643)	$ 164,811

Investment securities held to maturity (HTM):

	December 31, 2010			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Agency mortgage-backed securities	$ 6,824	$ 452	$	$ 7,276
Other securities	1,000		(9)	991
Total	$ 7,824	$ 452	$ (9)	$ 8,267

Maintaining investment quality is a primary objective of the Company s investment policy which, subject to certain limited exceptions, prohibits the purchase of any investment security below a Moody s Investor s Service or Standard & Poor s rating of A. At June 30, 2011 and December 31, 2010, 99.5% of the portfolio was rated AAA . None of the portfolio was rated below A or unrated at June 30, 2011. At June 30, 2011, the Company s consolidated investment securities portfolio had a modified duration of approximately 2.71 years. Total proceeds from the sale of AFS securities were $16.5 million in the first six months of 2011 compared to $1.8 million for the first six months of 2010. The gross losses on investment security sales in the first six months of 2011 were $358,000 compared to $107,000 of gross investment security gains for the first six months of 2010.

The following tables present information concerning investments with unrealized losses as of June 30, 2011 and December 31, 2010 (in thousands):

Investment securities available for sale:

	June 30, 2011					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Agency	$ 5,334	$ (14)	$	$	$ 5,334	$ (14)
U.S. Agency mortgage-backed securities	12,229	(59)			12,229	(59)
Total	$ 17,563	$ (73)	$	$	$ 17,563	$ (73)

Investment securities held to maturity:

	June 30, 2011					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Other securities	$	$	$ 994	$ (6)	$ 994	$ (6)
Total	$	$	$ 994	$ (6)	$ 994	$ (6)

Investment securities available for sale:

	December 31, 2010					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Agency	$ 4,204	$ (69)	$	$	$ 4,204	$ (69)
U.S. Agency mortgage-backed securities	38,202	(574)			38,202	(574)
Total	$ 42,406	$ (643)	$	$	$ 42,406	$ (643)

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Investment securities held to maturity:

	December 31, 2010					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Other securities	$	$	$ 991	$ (9)	$ 991	$ (9)
Total	$	$	$ 991	$ (9)	$ 991	$ (9)

The unrealized losses are primarily a result of increases in market yields from the time of purchase. In general, as market yields rise, the value of securities will decrease; as market yields fall, the fair value of securities will increase. There are 14 positions that are considered temporarily impaired at June 30, 2011. Management generally views changes in fair value caused by changes in interest rates as temporary; therefore, these securities have not been classified as other-than-temporarily impaired. Management has also concluded that based on current information we expect to continue to receive scheduled interest payments as well as the entire principal balance. Furthermore, we do not intend to sell these securities and do not believe we will be required to sell these securities before they recover in value.

Contractual maturities of securities at June 30, 2011, are shown below (in thousands). Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without prepayment penalties.

Maturity	Available for Sale		Held to Maturity	
	Cost Basis	Fair Value	Cost Basis	Fair Value
0-1 year	$	$	$	$
1-5 years	12,321	12,379	1,000	994
5-10 years	19,422	20,430		
10-15 years	83,581	85,496		
Over 15 years	69,190	71,356	8,109	8,574
Total	$ 184,514	$ 189,661	$ 9,109	$ 9,568

8. **Loans**

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

	June 30, 2011	December 31, 2010
Commercial	$ 75,709	$ 78,322
Commercial loans secured by real estate	353,015	369,904
Real estate mortgage	207,406	203,317
Consumer	18,222	19,233
Loans, net of unearned income	$ 654,352	$ 670,776

Loan balances at June 30, 2011 and December 31, 2010 are net of unearned income of $382,000 and $477,000, respectively.

Real estate-construction loans comprised 2.6%, and 3.9% of total loans, net of unearned income, at June 30, 2011 and December 31, 2010, respectively. The Company has no exposure to sub prime mortgage loans in either the loan or investment portfolios.

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9. **Allowance for Loan Losses**

An analysis of the changes in the allowance for loan losses follows (in thousands, except ratios):

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Balance at beginning of period	$ 18,025	$ 21,516	$ 19,765	$ 19,685
Charge-offs:				
Commercial	(243)	(166)	(942)	(205)
Commercial loans secured by real estate		(1,758)	(638)	(2,951)
Real estate-mortgage	(29)	(78)	(40)	(158)
Consumer	(77)	(50)	(110)	(134)
Total charge-offs	(349)	(2,052)	(1,730)	(3,448)
Recoveries:				
Commercial	364	49	524	153
Commercial loans secured by real estate	65		66	37
Real estate-mortgage	2	3	26	5
Consumer	26	21	82	55
Total recoveries	457	73	698	250
Net recoveries (charge-offs)	108	(1,979)	(1,032)	(3,198)
Provision (credit) for loan losses	(1,175)	1,200	(1,775)	4,250
Balance at end of period	$ 16,958	$ 20,737	$ 16,958	$ 20,737
As a percent of average loans and loans held for sale, net of unearned income:				
Annualized net (recoveries) charge-offs	(0.07)%	1.13%	0.32%	0.91%
Annualized provision (credit) for loan losses	(0.72)	0.68	(0.55)	1.20
Allowance as a percent of loans and loans held for sale, net of unearned income at period end	2.58	2.99	2.58	2.99

The following tables summarize the rollforward of the allowance for loan loss by portfolio segment (in thousands).

	Balance at December 31, 2010	Charge-Offs	Recoveries	Provision (Credit)	Balance at June 30, 2011
Commercial	$ 3,851	$ (942)	$ 524	$ 1,121	$ 4,554
Commercial loans secured by real estate	12,717	(638)	66	(2,918)	9,227
Real estate- mortgage	1,117	(40)	26	191	1,294
Consumer	206	(110)	82	15	193
Allocation for general risk	1,874			(184)	1,690
Total	$ 19,765	$ (1,730)	$ 698	$ (1,775)	$ 16,958

The following tables summarize the primary segments of the loan portfolio (in thousands).

	At June 30, 2011				
	Commercial	Commercial Loans Secured By Real Estate	Real Estate-Mortgage	Consumer	Total
Individually evaluated for impairment	$ 24	$ 5,832	$	$	$ 5,856
Collectively evaluated for impairment	75,685	347,183	207,406	18,222	648,496
Total loans	$ 75,709	$ 353,015	$ 207,406	$ 18,222	$ 654,352

	At June 30, 2011					
	Commercial	Commercial Loans Secured By Real Estate	Real Estate-Mortgage	Consumer	Allocation for General Risk	Total
Specific reserve allocation	$	$ 2,014	$	$	$	$ 2,014
General reserve allocation	4,554	7,213	1,294	193	1,690	14,944
Total allowance for loan losses	$ 4,554	$ 9,227	$ 1,294	$ 193	$ 1,690	$ 16,958

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	At December 31, 2010				
	Commercial	Commercial Loans Secured By Real Estate	Real Estate-Mortgage	Consumer	Total
Individually evaluated for impairment	$ 4,065	$ 8,082	$	$	$ 12,147
Collectively evaluated for impairment	74,257	361,822	203,317	19,233	658,629
Total loans	$ 78,322	$ 369,904	$ 203,317	$ 19,233	$ 670,776

	At December 31, 2010					
	Commercial	Commercial Loans Secured By Real Estate	Real Estate-Mortgage	Consumer	Allocation for General Risk	Total
Specific reserve allocation	$ 1,905	$ 1,901	$	$	$	$ 3,806
General reserve allocation	1,946	10,816	1,117	206	1,874	15,959
Total allowance for loan losses	$ 3,851	$ 12,717	$ 1,117	$ 206	$ 1,874	$ 19,765

The segments of the Company s loan portfolio are disaggregated to a level that allows management to monitor risk and performance. The overall risk profile for the commercial loan segment is driven by non-owner occupied commercial real estate (CRE) loans, which include loans secured by non-owner occupied nonfarm nonresidential properties, as the majority of the commercial portfolio is centered in these types of accounts. The residential mortgage loan segment is comprised of first lien amortizing residential mortgage loans and home equity loans. The consumer loan segment consists primarily of installment loans and overdraft lines of credit connected with customer deposit accounts.

Management evaluates for possible impairment any individual loan in the commercial segment with a loan balance in excess of $100,000 that is in nonaccrual status or classified as a Troubled Debt Restructure (TDR). Loans are considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. The Company does not separately evaluate individual consumer and residential mortgage loans for impairment, unless such loans are part of a larger relationship that is impaired, or are classified as a TDR agreement.

Once the determination has been made that a loan is impaired, the determination of whether a specific allocation of the allowance is necessary is measured by comparing the recorded investment in the loan to the fair value of the loan using one of three methods: (a) the present value of expected future cash flows discounted at the loan s effective interest rate; (b) the loan s observable market price; or (c) the fair value of the collateral less selling costs for collateral dependent loans. The method is selected on a loan-by loan basis, with management primarily utilizing the fair value of collateral method. The evaluation of the need and amount of a specific allocation of the allowance and whether a loan can be removed from impairment status is made on a quarterly basis. The Company s policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition.

The need for an updated appraisal on collateral dependent loans is determined on a case by case basis. The useful life of an appraisal or evaluation will vary depending upon the circumstances of the property and the economic conditions in the marketplace. A new appraisal is not required if there is an existing appraisal which, along with other information, is sufficient to determine a reasonable value for the property and to support an appropriate and adequate allowance for loan losses. At a minimum, annual documented reevaluation of the property is completed by the bank s Assigned Risk department to support the value of the property.

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When reviewing an appraisal associated with an existing real estate transaction, the Assigned Risk department must determine if there have been material changes to the underlying assumptions in the appraisal which affect the original estimate of value. Some of the factors that could cause material changes to reported values include:

- the passage of time;
- the volatility of the local market;
- the availability of financing;
- natural disasters;
- the inventory of competing properties;
- new improvements to, or lack of maintenance of, the subject property or competing properties upon physical inspection by the bank;
- changes in underlying economic and market assumptions, such as material changes in current and projected vacancy, absorption rates, capitalization rates, lease terms, rental rates, sales prices, concessions, construction overruns and delays, zoning changes, etc.; and
- environmental contamination.

The value of the property is adjusted to appropriately reflect the above listed factors and the value is discounted to reflect the value impact of a forced or distressed sale, any outstanding senior liens, any outstanding unpaid real estate taxes, transfer taxes and closing costs that would occur with sale of the real estate. If the Assigned Risk department personnel determine that a reasonable value cannot be derived based on available information, a new appraisal is ordered. The determination of the need for a new appraisal, versus completion of a property valuation by the bank s Assigned Risk department personnel rests with the Assigned Risk department and not the originating account officer.

The following tables present impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary (in thousands).

	June 30, 2011				
	Impaired Loans with Specific Allowance		Impaired Loans with No Specific Allowance	Total Impaired Loans	
	Recorded Investment	Related Allowance	Recorded Investment	Recorded Investment	Unpaid Principal Balance
Commercial	$	$	$ 24	$ 24	$ 731
Commercial loans secured by real estate	5,832	2,014		5,832	6,655
Total impaired loans	$ 5,832	$ 2,014	$ 24	$ 5,856	$ 7,386

	December 31, 2010				
	Impaired Loans with Specific Allowance		Impaired Loans with No Specific Allowance	Total Impaired Loans	
	Recorded Investment	Related Allowance	Recorded Investment	Recorded Investment	Unpaid Principal Balance
Commercial	$ 4,041	$ 1,905	$ 24	$ 4,065	$ 4,842
Commercial loans secured by real estate	4,938	1,901	3,144	8,082	8,341
Total impaired loans	$ 8,979	$ 3,806	$ 3,168	$ 12,147	$ 13,183

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The following table presents the average recorded investment in impaired loans and related interest income recognized for the periods indicated (in thousands).

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Average investment in impaired loans	$ 6,636	$ 17,725	$ 9,001	$ 16,393
Interest income recognized on a cash basis on impaired loans		121	173	242

Management uses a ten point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized. The first five Pass categories are aggregated, while the Pass 6, Special Mention, Substandard and Doubtful categories are disaggregated to separate pools. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due, or for which any portion of the loan represents a specific allocation of the allowance for loan losses are placed in Substandard or Doubtful.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Company has a structured loan rating process, which dictates that, at a minimum, credit reviews are mandatory for all commercial and commercial mortgage loan relationships with aggregate balances in excess of $250,000 within a 12-month period. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as bankruptcy, delinquency, or death occurs to raise awareness of a possible credit event. The Company s commercial relationship managers are responsible for the timely and accurate risk rating of the loans in their portfolios at origination and on an ongoing basis. Risk ratings are assigned by the account officer, but require independent review and rating concurrence from the Company s internal Loan Review Department. The Loan Review Department is an experienced independent function which reports directly to the Board Audit Committee. The scope of commercial portfolio coverage by the Loan Review Department is defined and presented to the Audit Committee for approval on an annual basis. The anticipated scope of coverage for 2011 requires a minimum range-of-coverage of 60% to 70% of the commercial loan portfolio.

In addition to loan monitoring by the account officer and Loan Review Department, the Company also requires presentation of all credits rated Pass-6 with aggregate balances greater than $1,000,000, all credits rated Special Mention or Substandard with aggregate balances greater than $250,000, and all credits rated Doubtful with aggregate balances greater than $100,000 on an individual basis to the Company s Loan Loss Reserve Committee on a quarterly basis.

The following tables present the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard and Doubtful within the internal risk rating system (in thousands).

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	June 30, 2011				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 72,372	$ 237	$ 3,100	$	$ 75,709
Commercial loans secured by real estate	303,336	26,034	23,244	401	353,015
Total	$ 375,708	$ 26,271	$ 26,344	$ 401	$ 428,724

	December 31, 2010				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 61,961	$ 8,797	$ 5,793	$ 1,771	$ 78,322
Commercial loans secured by real estate	306,555	33,165	29,754	430	369,904
Total	$ 368,516	$ 41,962	$ 35,547	$ 2,201	$ 448,226

It is the policy of the bank that the outstanding balance of any residential mortgage loan that exceeds 90-days past due as to principal and/or interest is transferred to non-accrual status and an evaluation is completed to determine the fair value of the collateral less selling costs. A charge down is recorded for any deficiency balance determined from the collateral evaluation. The remaining non-accrual balance is reported as impaired with no specific allowance. It is the policy of the bank that the outstanding balance of any consumer loan that exceeds 90-days past due as to principal and/or interest is charged off.

	June 30, 2011	
	Performing	Non-performing
	(In thousands)	
Real estate- mortgage	$ 205,731	$ 1,675
Consumer	18,222	
Total	$ 223,953	$ 1,675

	December 31, 2010	
	Performing	Non-performing
	(In thousands)	
Real estate- mortgage	$ 201,438	$ 1,879
Consumer	19,233	
Total	$ 220,671	$ 1,879

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans (in thousands).

	June 30, 2011						
	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days Past Due And Accruing	Total Past Due	Non-Accrual	Total Loans

Commercial	$ 75,685	$	$	$	$	$ 24	$ 75,709
Commercial loans secured by real estate	347,805					5,210	353,015
Real estate- mortgage	203,893	1,631	207		1,838	1,675	207,406
Consumer	18,118	83	21		104		18,222
Total	$ 645,501	$ 1,714	$ 228	$	$ 1,942	$ 6,909	$ 654,352

	December 31, 2010						
	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days Past Due And Accruing	Total Past Due	Non-Accrual	Total Loans
Commercial	$ 74,643	$	$	$	$	$ 3,679	$ 78,322
Commercial loans secured by real estate	362,890	283			283	6,731	369,904
Real estate- mortgage	199,003	1,892	543		2,435	1,879	203,317
Consumer	19,160	29	44		73		19,233
Total	$ 655,696	$ 2,204	$ 587	$	$ 2,791	$ 12,289	$ 670,776

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An allowance for loan losses (ALL) is maintained to absorb losses from the loan portfolio. The ALL is based on management s continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of non-performing loans.

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are modified by other qualitative factors.

Management tracks the historical net charge-off activity at each risk rating grade level for the entire commercial portfolio and at the aggregate level for the consumer, residential mortgage and small business portfolios. A historical charge-off factor is calculated utilizing a rolling 12 consecutive historical quarters for the commercial portfolios. This historical charge-off factor for the consumer, residential mortgage and small business portfolios are based on a three year historical average of actual loss experience.

The Company uses a comprehensive methodology and procedural discipline to maintain an ALL to absorb inherent losses in the loan portfolio. The Company believes this is a critical accounting policy since it involves significant estimates and judgments. The allowance consists of three elements: 1) an allowance established on specifically identified problem loans, 2) formula driven general reserves established for loan categories based upon historical loss experience and other qualitative factors which include delinquency and non-performing loan trends, economic trends, concentrations of credit, trends in loan volume, experience and depth of management, examination and audit results, effects of any changes in lending policies, and trends in policy, financial information, and documentation exceptions, and 3) a general risk reserve which provides support for variance from our assessment of the previously listed qualitative factors, provides protection against credit risks resulting from other inherent risk factors contained in the Company s loan portfolio, and recognizes the model and estimation risk associated with the specific and formula driven allowances. The qualitative factors used in the formula driven general reserves are evaluated quarterly (and revised if necessary) by the Company s management to establish allocations which accommodate each of the listed risk factors.

Pass rated credits are segregated from Criticized credits for the application of qualitative factors.

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL.

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10. **Non-performing Assets Including Trouble Debt Restructurings**

The following table presents information concerning non-performing assets including TDR (in thousands, except percentages):

	June 30, 2011	December 31, 2010
Non-accrual loans		
Commercial	$ 24	$ 3,679
Commercial loans secured by real estate	5,210	6,731
Real estate-mortgage	1,675	1,879
Total	6,909	12,289
Other real estate owned		
Commercial loans secured by real estate		436
Real estate-mortgage	209	302
Total	209	738
Total restructured loans not in non-accrual (TDR)	315	1,337
Total non-performing assets including TDR	$ 7,433	$ 14,364
Total non-performing assets as a percent of loans and loans held for sale, net of unearned income, and other real estate owned	1.13%	2.12%

Consistent with accounting and regulatory guidance, the bank recognizes a TDR when the bank, for economic or legal reasons related to a borrower s financial difficulties, grants a concession to the borrower that would not normally be considered. Regardless of the form of concession granted, the bank s objective in offering a troubled debt restructure is to increase the probability of repayment of the borrower s loan.

To be considered a TDR, both of the following criteria must be met:

- the borrower must be experiencing financial difficulties; and
- the bank, for economic or legal reasons related to the borrower s financial difficulties, grants a concession to the borrower that would not otherwise be considered.

Factors that indicate a borrower is experiencing financial difficulties include, but are not limited to:

- the borrower is currently in default on their loan(s);
- the borrower has filed for bankruptcy;
- the borrower has insufficient cash flows to service their loan(s); and

the borrower is unable to obtain refinancing from other sources at a market rate similar to rates available to a non-troubled debtor.
Factors that indicate that a concession has been granted include, but are not limited to:

the borrower is granted an interest rate reduction to a level below market rates for debt with similar risk; or

the borrower is granted a material maturity date extension, or extension of the amortization plan to provide payment relief. For purposes of this policy, a material maturity date extension will generally include any maturity date extension, or the aggregate of multiple consecutive maturity date extensions, that exceed 120 days. A restructuring that results in an insignificant delay in payment, i.e. 120 days or less, is not necessarily a TDR. Insignificant payment delays occur when the amount of the restructured payments subject to the delay is insignificant relative to the unpaid principal or collateral value, and will result in an insignificant shortfall in the originally scheduled contractual amount due, and/or the delay in timing of the restructured payment period is insignificant relative to the frequency of payments, the original maturity or the original amortization.

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

Any loan modification where the borrower s aggregate exposure is at least $250,000 and where the loan currently maintains a criticized or classified risk rating, i.e. OLEM, Substandard or Doubtful, or where the loan will be assigned a criticized or classified rating after the modification is evaluated to determine the need for TDR classification.

The following table details the TDRs at June 30, 2011 (dollars in thousands).

Loans in accrual status	# of Loans	Current Balance	Concession Granted
Commercial loan secured by real estate	1	$ 315	Extension of maturity date

Loans in non-accrual status	# of Loans	Current Balance	Concession Granted
Commercial loan secured by real estate	3	$ 2,303	Extension of maturity date

The following table details the TDRs at December 31, 2010 (dollars in thousands).

Loans in accrual status	# of Loans	Current Balance	Concession Granted
Commercial loan secured by real estate	2	$ 1,337	Extension of maturity date

Once a loan is classified as a TDR, this classification will remain until documented improvement in the financial position of the account supports confidence that all principal and interest will be paid according to terms. Additionally, the customer must have re-established a track record of timely payments according to the restructured contract terms for a minimum of six (6) consecutive months prior to consideration for removing the loan from TDR status. However, a loan will continue to be on non-accrual status until, consistent with our policy, the borrower has made a minimum of 12 consecutive payments in accordance with the terms of the loan.

As of June 30, 2011, both TDR loans reflected above in accrual status as of December 31, 2010 were repaid in full.

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

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Interest income due in accordance with original terms	$ 94	$ 293	$ 229	$ 537
Interest income recorded		(121)	(173)	(242)
Net reduction in interest income	$ 94	$ 172	$ 56	$ 295

11. **Federal Home Loan Bank Borrowings**

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

	At June 30, 2011		
Type	Maturing	Amount	Weighted Average Rate
Open Repo Plus	Overnight	$	%
Advances	2012	4,000	1.82
	2013	5,000	2.04
	2016 and after	722	6.43
Total advances		9,722	2.27
Total FHLB borrowings		$ 9,722	2.27%

	At December 31, 2010		
Type	Maturing	Amount	Weighted Average Rate
Open Repo Plus	Overnight	$ 4,550	0.62%
Advances	2012	4,000	1.82
	2013	5,000	2.04
	2016 and after	750	6.44
Total advances		9,750	2.28
Total FHLB borrowings		$ 14,300	1.75%

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

12. **Preferred Stock**

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (initially introduced as the Troubled Asset Relief Program or TARP) was enacted. On October 14, 2008, the U.S. Treasury announced its intention to inject capital into financial institutions under the TARP Capital Purchase Program (the CPP). The CPP is a voluntary program designed to provide capital to healthy well managed financial institutions in order to increase the availability of credit to businesses and individuals and help stabilize the U.S. financial system.

On December 19, 2008, the Company sold to the U.S. Treasury for an aggregate purchase price of $21 million in cash 21,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series D. In conjunction with the purchase of these senior preferred shares, the U.S. Treasury also

received a warrant to purchase up to 1,312,500 shares of the Company s common stock. The warrant has a term of 10 years and is exercisable at any time, in whole or in part, at an exercise price of $2.40 per share. The $21 million in proceeds was allocated to the Series D Preferred Stock and the warrant based on their relative fair values at issuance (approximately $20.4 million was allocated to the Series D Preferred Stock and approximately $600,000 to the warrant). The

difference between the initial value allocated to the Series D Preferred Stock of approximately $20.4 million and the liquidation value of $21 million will be charged to retained earnings over the first five years of the contract. Cumulative dividends on Series D Preferred Stock are payable quarterly at 5% through December 19, 2013 and at a rate of 9% thereafter. As a result of the decision by the Company to accept a preferred stock investment under the U.S. Treasury s CPP, for a period of three years ending December 19, 2011, the Company is no longer permitted to repurchase common stock or declare and pay dividends on common stock without the consent of the U.S. Treasury.

13. **Regulatory Capital**

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

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. As of June 30, 2011, the Federal Reserve categorized the Company as Well Capitalized under the regulatory framework for prompt corrective action. The Company believes that no conditions or events have occurred that would change this conclusion. To be categorized as well capitalized, the Company must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. Additionally, while not a regulatory capital ratio, the Company s tangible common equity ratio was 8.29% at June 30, 2011 (in thousands, except ratios).

AS OF JUNE 30, 2011

ACTUAL