FRANKLIN FINANCIAL SERVICES CORP /PA/
Form 4
November 04, 2016

FORM 4

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

OMB APPROVAL

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Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
Duffey Gregory A

(Last) (First) (Middle)

20 SOUTH MAIN STREET

(Street)

CHAMBERSBURG, PA 17201

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
FRANKLIN FINANCIAL SERVICES CORP /PA/ [FRAF]

3. Date of Earliest Transaction (Month/Day/Year)
11/02/2016

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director _____ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Franklin Financial Services Corp.	11/02/2016		P		40	A	$ 24.68	3,280	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
Duffey Gregory A 20 SOUTH MAIN STREET CHAMBERSBURG, PA 17201	X			

Signatures

Gregory A. Duffey by Amanda Ducey, Corporate Secretary	11/04/2016
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

Remarks:

POA on file with Corporation.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. /TD> 21 343 8 2 8,160 239

$14,495	$751	26	$343	$8	2	$14,838	$759

Explanation of Responses:

Available-for-Sale Securities:

U.S. Government - Sponsored enterprises (GSEs)

$108,234 $4,358 37 $19,479 $1,603 7 $127,713 $5,961

Mortgage-backed:

Government-sponsored Enterprises (GSEs)* residential

97,805 1,449 32 1,866 32 2 99,671 1,481

Obligations of states and political subdivisions

5,645 95 14 4,766 314 14 10,411 409

Explanation of Responses:

$211,684	$5,902	83	$26,111	$1,949	23	$237,795	$7,851

Explanation of Responses:

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Explanation of Responses:

Because the Company does not intend to sell these securities and it is not more likely than not that the Company will be required to sell the securities before recovery of their amortized cost bases, which may be at maturity, the Company does not consider these securities to be other-than-temporarily impaired at March 31, 2014.

The carrying values of the Company s investment securities could decline in the future if the financial condition of issuers deteriorate and management determines it is probable that the Company will not recover the entire amortized cost bases of the securities. As a result, there is a risk that other-than-temporary impairment charges may occur in the future given the current economic environment.

Note 4. Earnings Per Share

The computation of basic earnings per share is based on the weighted average number of common shares outstanding during the period. The computation of diluted earnings per share for the Company begins with the basic earnings per share plus the effect of common shares contingently issuable from stock options.

The following is a summary of components comprising basic and diluted earnings per share (EPS) for the three months ended March 31, 2014 and 2013:

	2014	2013
	(Dollars in Thousands Except Per Share Amounts)	
Basic EPS Computation:		
Numerator Earnings available to common Stockholders	$ 4,172	$ 2,978
Denominator Weighted average number of common shares outstanding	7,522,280	7,445,701
Basic earnings per common share	$ .55	$ .40
Diluted EPS Computation:		
Numerator Earnings available to common Stockholders	$ 4,172	$ 2,978
Denominator Weighted average number of common shares outstanding	7,522,280	7,445,701
Dilutive effect of stock options	4,356	4,842
	7,526,636	7,450,543
Diluted earnings per common share	$ .55	$ .40

Note 5. Income Taxes

Accounting Standards Codification (ASC) 740, *Income Taxes*, defines the threshold for recognizing the benefits of tax return positions in the financial statements as more-likely-than-not to be sustained by the taxing authority. This section also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties, and includes guidance concerning accounting for income tax uncertainties in interim periods. As of March 31, 2014, the Company had no unrecognized tax benefits related to Federal or State income tax matters and does not anticipate any material increase or decrease in unrecognized tax benefits relative to any tax positions taken prior to March 31, 2014.

As of March 31, 2014, the Company has accrued no interest and no penalties related to uncertain tax positions. The Company s policy is to recognize interest and/or penalties related to income tax matters in income tax expense.

The Company and its subsidiaries file consolidated U.S. Federal and state of Tennessee income tax returns. The Company is currently open to audit under the statute of limitations by the state of Tennessee for the years ended December 31, 2011 through 2013 and the IRS for the years ended December 31, 2011 through 2013.

Note 6. Commitments and Contingent Liabilities

In the normal course of business, the Bank has entered into off-balance sheet financial instruments which include commitments to extend credit (i.e., including unfunded lines of credit) and standby letters of credit. Commitments to extend credit are usually the result of lines of credit granted to existing borrowers under agreements that the total outstanding indebtedness will not exceed a specific amount during the term of the indebtedness. Typical borrowers are commercial concerns that use lines of credit to supplement their treasury management functions, thus their total outstanding indebtedness may fluctuate during any time period based on the seasonality of their business and the resultant timing of their cash flows. Other typical lines of credit are related to home equity loans granted to consumers. Commitments to extend credit generally have fixed expiration dates or other termination clauses and may require payment of a fee.

Standby letters of credit are generally issued on behalf of an applicant (our customer) to a specifically named beneficiary and are the result of a particular business arrangement that exists between the applicant and the beneficiary. Standby letters of credit have fixed expiration dates and are usually for terms of two years or less unless terminated beforehand due to criteria specified in the standby letter of credit. A typical arrangement involves the applicant routinely being indebted to the beneficiary for such items as inventory purchases, insurance, utilities, lease guarantees or other third party commercial transactions. The standby letter of credit would permit the beneficiary to obtain payment from the Company under certain prescribed circumstances. Subsequently, the Company would then seek reimbursement from the applicant pursuant to the terms of the standby letter of credit.

The Company follows the same credit policies and underwriting practices when making these commitments as it does for on-balance sheet instruments. Each customer s creditworthiness is evaluated on a case-by-case basis, and the amount of collateral obtained, if any, is based on management s credit evaluation of the customer. Collateral held varies but may include cash, real estate and improvements, marketable securities, accounts receivable, inventory, equipment, and personal property.

The contractual amounts of these commitments are not reflected in the consolidated financial statements and would only be reflected if drawn upon. Since many of the commitments are expected to expire without being drawn upon, the contractual amounts do not necessarily represent future cash requirements. However, should the commitments be drawn upon and should our customers default on their resulting obligation to us, the Company s maximum exposure to credit loss, without consideration of collateral, is represented by the contractual amount of those instruments.

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A summary of the Company s total contractual amount for all off-balance sheet commitments at March 31, 2014 is as follows:

Commitments to extend credit	$ 225,404,000
Standby letters of credit	$ 27,529,000

The Company originates residential mortgage loans, sells them to third-party purchasers, and does not retain the servicing rights. These loans are originated internally and are primarily to borrowers in the Company s geographic market footprint. These sales are typically on a best efforts basis to investors that follow conventional government sponsored entities (GSE) and the Department of Housing and Urban Development/U.S. Department of Veterans Affairs (HUD/VA) guidelines. Generally, loans held for sale are underwritten by the Company, including HUD/VA loans.

Each purchaser has specific guidelines and criteria for sellers of loans, and the risk of credit loss with regard to the principal amount of the loans sold is generally transferred to the purchasers upon sale. While the loans are sold without recourse, the purchase agreements require the Company to make certain representations and warranties regarding the existence and sufficiency of file documentation and the absence of fraud by borrowers or other third parties such as appraisers in connection with obtaining the loan. If it is determined that the loans sold were in breach of these representations or warranties, the Company has obligations to either repurchase the loan for the unpaid principal balance and related investor fees or make the purchaser whole for the economic benefits of the loan.

To date, repurchase activity pursuant to the terms of these representations and warranties has been insignificant and has resulted in insignificant losses to the Company.

Based on information currently available, management believes that it does not have significant exposure to contingent losses that may arise relating to the representations and warranties that it has made in connection with its mortgage loan sales.

Various legal claims also arise from time to time in the normal course of business. In the opinion of management, the resolution of these claims outstanding at March 31, 2014 will not have a material impact on the Company s financial statements.

Note 7. Fair Value Measurements

FASB ASC 820, *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value in U.S. GAAP and expands disclosures about fair value measurements. The definition of fair value focuses on the exit price, i.e., the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, not the entry price, i.e., the price that would be paid to acquire the asset or received to assume the liability at the measurement date. The statement emphasizes that fair value is a market-based measurement; not an entity-specific measurement. Therefore, the fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability.

Valuation Hierarchy

FASB ASC 820 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 - inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

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Level 2 - inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 - inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument s categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Following is a description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy.

Assets

Securities available-for-sale - Where quoted prices are available for identical securities in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid government securities and certain other financial products. If quoted market prices are not available, then fair values are estimated by using pricing models that use observable inputs or quoted prices of securities with similar characteristics and are classified within Level 2 of the valuation hierarchy. In certain cases where there is limited activity or less transparency around inputs to the valuation and more complex pricing models or discounted cash flows are used, securities are classified within Level 3 of the valuation hierarchy.

Impaired loans - A loan is considered to be impaired when it is probable the Company will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. Impaired loans are measured based on the present value of expected payments using the loan s original effective rate as the discount rate, the loan s observable market price, or the fair value of the collateral less selling costs if the loan is collateral dependent. If the recorded investment in the impaired loan exceeds the measure of fair value, a valuation allowance may be established as a component of the allowance for loan losses or the expense is recognized as a charge-off. Impaired loans are classified within Level 3 of the valuation hierarchy due to the unobservable inputs used in determining their fair value such as collateral values and the borrower s underlying financial condition.

Other real estate owned - Other real estate owned (OREO) represents real estate foreclosed upon by the Company through loan defaults by customers or acquired in lieu of foreclosure. Substantially all of these amounts relate to construction and land development, other land secured loans, and commercial real estate loans for which the Company believes it has adequate collateral. Upon foreclosure, the property is recorded at the lower of cost or fair value, based on appraised value, less selling costs estimated as of the date acquired with any loss recognized as a charge-off through the allowance for loan losses. Additional OREO losses for subsequent valuation downward adjustments are determined on a specific property basis and are included as a component of noninterest expense along with holding costs. Any gains or losses realized at the time of disposal are also reflected in noninterest expense, as applicable. OREO is included in Level 3 of the valuation hierarchy due to the lack of observable market inputs into the determination of fair value. Appraisal values are property-specific and sensitive to the changes in the overall economic environment.

Other assets Included in other assets are certain assets carried at fair value, including the cash surrender value of bank owned life insurance policies and annuity contracts. The Company uses financial information received from insurance carriers indicating the performance of the insurance policies and cash surrender values in determining the carrying value of life insurance. The Company reflects these assets within Level 3 of the valuation hierarchy due to the unobservable inputs included in the valuation of these items. The Company does not consider the fair values of these policies to be materially sensitive to changes in these unobservable inputs.

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The following tables present the financial instruments carried at fair value as of March 31, 2014 and December 31, 2013, by caption on the consolidated balance sheet and by FASB ASC 820 valuation hierarchy (as described above) (in thousands):

	Assets and Liabilities Measured at Fair Value on a Recurring Basis			
	Total Carrying Value in the Consolidated Balance Sheet	Quoted Market Prices in an Active Market (Level 1)	Models with Significant Observable Market Parameters (Level 2)	Models with Significant Unobservable Market Parameters (Level 3)
March 31, 2014				
Investment securities available-for-sale:				
U.S. Government sponsored enterprises	$ 150,724		150,724	
Mortgage-backed securities	193,394		193,394	
State and municipal securities	13,454		13,454	
Total investment securities available-for-sale	357,572		357,572	
Other assets	16,437			16,437
Total assets at fair value	$ 374,009		357,572	16,437
December 31, 2013				
Investment securities available-for-sale:				
U.S. Government sponsored enterprises	$ 140,818		140,818	
Mortgage-backed securities	175,182		175,182	
State and municipal securities	13,373		13,373	
Total investment securities available-for-sale	329,373		329,373	
Other assets	11,390			11,390
Total assets at fair value	$ 340,763		329,373	11,390

	Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis			
	Total Carrying Value in the Consolidated Balance Sheet	Quoted Market Prices in an Active Market (Level 1)	Models with Significant Observable Market Parameters (Level 2)	Models with Significant Unobservable Market Parameters (Level 3)
March 31, 2014				

Other real estate owned	$	11,522	11,522
Impaired loans, net [1]		17,419	17,419
Total	$	28,941	28,941
December 31, 2013			
Other real estate owned	$	12,869	12,869
Impaired loans, net [1]		22,380	22,380
Total	$	35,249	35,249

[1] *Amount is net of a valuation allowance of $3.2 million at March 31, 2014 and $4.5 million at December 31, 2013 as required by ASC 310-10, Receivables.*

In the case of the bond portfolio, the Company monitors the valuation technique utilized by various pricing agencies to ascertain when transfers between levels have been affected. The nature of the remaining assets and liabilities is such that transfers in and out of any level are expected to be rare. For the three months ended March 31, 2014, there were no transfers between Levels 1, 2 or 3.

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The table below includes a rollforward of the balance sheet amounts for the three months ended March 31, 2014 and 2013 (including the change in fair value) for financial instruments classified by the Company within Level 3 of the valuation hierarchy for assets and liabilities measured at fair value on a recurring basis. When a determination is made to classify a financial instrument within Level 3 of the valuation hierarchy, the determination is based upon the significance of the unobservable factors to the overall fair value measurement. However, since Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components (that is, components that are actively quoted and can be validated to external sources), the gains and losses in the table below include changes in fair value due in part to observable factors that are part of the valuation methodology (in thousands):

	For the Three Months Ended March 31,			
	2014		**2013**	
	Other Assets	Other Liabilities	Other Assets	Other Liabilities
Fair value, January 1	$ 11,390		6,315	
Total realized gains included in income	47		23	
Change in unrealized gains/losses included in other comprehensive income for assets and liabilities still held at March 31				
Purchases, issuances and settlements, net	5,000			
Transfers out of Level 3				
Fair value, March 31	$ 16,437		6,338	
Total realized gains included in income related to financial assets and liabilities still on the consolidated balance sheet at March 31	$			

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments that are not measured at fair value. In cases where quoted market prices or observable components are not available, fair values are based on estimates using discounted cash flow models. Those models are significantly affected by the assumptions used, including the discount rates, estimates of future cash flows and borrower creditworthiness. The fair value estimates presented herein are based on pertinent information available to management as of March 31, 2014 and December 31, 2013. Such amounts have not been revalued for purposes of these consolidated financial statements since those dates and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

Held-to-maturity securities - Estimated fair values for investment securities are based on quoted market prices where available. If quoted market prices are not available, then fair values are estimated by using pricing models that use observable inputs or quoted prices of securities with similar characteristics.

Loans - The fair value of our loan portfolio includes a credit risk factor in the determination of the fair value of our loans. This credit risk assumption is intended to approximate the fair value that a market participant would realize in a hypothetical orderly transaction. Our loan portfolio is initially fair valued using a segmented approach. We divide our loan portfolio into the following categories: variable rate loans, impaired loans and all other loans. The results are then adjusted to account for credit risk.

For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values approximate carrying values. Fair values for impaired loans are estimated using discounted cash flow models or based on the fair value of the underlying collateral. For other loans, fair values are estimated using discounted cash flow models, using current market interest rates offered for loans with similar terms to borrowers of similar credit quality. The values derived from the discounted cash flow approach for each of the above portfolios are then further discounted to incorporate credit risk to determine the exit price.

Mortgage loans held-for-sale **-** Mortgage loans held-for-sale are carried at the lower of cost or fair value. The estimate of fair value is equal to the carrying value of these loans as they are usually sold within a few weeks of their origination.

Deposits and Securities sold under agreements to repurchase - The carrying amounts of demand deposits, savings deposits and securities sold under agreements to repurchase, approximate their fair values. Fair values for certificates of deposit are estimated using discounted cash flow models, using current market interest rates offered on certificates with similar remaining maturities.

Off-Balance Sheet Instruments - The fair values of the Company s off-balance-sheet financial instruments are based on fees charged to enter into similar agreements. However, commitments to extend credit do not represent a significant value to the Company until such commitments are funded.

The following table presents the carrying amounts, estimated fair value and placement in the fair valuation hierarchy of the Company s financial instruments at March 31, 2014 and December 31, 2013. This table excludes financial instruments for which the carrying amount approximates fair value. For short-term financial assets such as cash and cash equivalents, the carrying amount is a reasonable estimate of fair value due to the relatively short time between the origination of the instrument and its expected realization. For financial liabilities such as noninterest bearing demand, interest-bearing demand, and savings deposits, the carrying amount is a reasonable estimate of fair value due to these products having no stated maturity.

(in Thousands)	Carrying/ Notional Amount	Estimated Fair Value (1)	Quoted Market Prices in an Active Market (Level 1)	Models with Significant Observable Market Parameters (Level 2)	Models with Significant Unobservable Market Parameters (Level 3)
March 31, 2014					
Financial assets:					
Securities held-to-maturity	$ 29,283	29,159		29,159	
Loans, net	1,192,359	1,197,806			1,197,806
Mortgage loans held-for-sale	6,315	6,315			6,315
Financial liabilities:					
Deposits and securities sold under agreements to repurchase	1,607,831	1,453,877			1,453,877
Off-balance sheet instruments:					
Commitments to extend credit					
Standby letters of credit					
December 31, 2013					
Financial assets:					
Securities held-to-maturity	$ 26,823	26,561		26,561	
Loans, net	1,184,267	1,185,271			1,185,271
Mortgage loans held-for-sale	7,022	7,022			7,022
Financial liabilities:					
Deposits and securities sold under agreements to repurchase	1,563,333	1,554,839			1,554,839
Off-balance sheet instruments:					
Commitments to extend credit					
Standby letters of credit					

(1) Estimated fair values are consistent with an exit-price concept. The assumptions used to estimate the fair values are intended to approximate those that a market-participant would realize in a hypothetical orderly transaction.

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

The purpose of this discussion is to provide insight into the financial condition and results of operations of the Company and its bank subsidiary. This discussion should be read in conjunction with the consolidated financial statements appearing elsewhere in this report. Reference should also be made to the Company s Annual Report on Form 10-K for the year ended December 31, 2013 for a more complete discussion of factors that impact liquidity, capital and the results of operations.

Forward-Looking Statements

This Form 10-Q contains certain forward-looking statements regarding, among other things, the anticipated financial and operating results of the Company. Investors are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to publicly release any modifications or revisions to these forward-looking statements to reflect events or circumstances occurring after the date hereof or to reflect the occurrence of unanticipated events.

In connection with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, the Company cautions investors that future financial and operating results may differ materially from those projected in forward-looking statements made by, or on behalf of, the Company. The words expect, intend, should, may, could believe, suspect, anticipate, seek, plan, estimate and similar expressions are intended to identify such forward statements, but other statements not based on historical fact may also be considered forward-looking. Such forward-looking statements involve known and unknown risks and uncertainties, including, but not limited to those described in the Company s Annual Report on Form 10-K for the year ended December 31, 2013, and also include, without limitation, (i) deterioration in the financial condition of borrowers resulting in significant increases in loan losses and provisions for these losses, (ii) greater than anticipated deterioration in the real estate market conditions in the Company s market areas, (iii) increased competition with other financial institutions, (iv) the deterioration of the economy in the Company s market area, (v) continuation of the extremely low short-term interest rate environment or rapid fluctuations in short-term interest rates, (vi) significant downturns in the business of one or more large customers, (vii) the inability of the Company to comply with regulatory capital requirements, including those resulting from recently adopted changes to capital calculation methodologies and required capital maintenance levels; (viii) changes in state or Federal regulations, policies, or legislation applicable to banks and other financial service providers, including regulatory or legislative developments arising out of current unsettled conditions in the economy, including implementation of the Dodd Frank Wall Street Reform and Consumer Protection Act, (ix) changes in capital levels and loan underwriting, credit review or loss reserve policies associated with economic conditions, examination conclusions, or regulatory developments, (x) inadequate allowance for loan losses, (xi) the effectiveness of the Company s activities in improving, resolving or liquidating lower quality assets, (xii) results of regulatory examinations, and (xiii) loss of key personnel. These risks and uncertainties may cause the actual results or performance of the Company to be materially different from any future results or performance expressed or implied by such forward-looking statements. The Company s future operating results depend on a number of factors which were derived utilizing numerous assumptions that could cause actual results to differ materially from those projected in forward-looking statements.

Critical Accounting Estimates

The accounting principles we follow and our methods of applying these principles conform with U.S. generally accepted accounting principles and with general practices within the banking industry. In connection with the application of those principles, we have made judgments and estimates which, in the case of the determination of our allowance for loan losses have been critical to the determination of our financial position and results of operations. There have been no significant changes to our critical accounting policies as discussed in our Annual Report on Form 10-K for the year ended December 31, 2013.

Allowance for Loan Losses (allowance). Our management assesses the adequacy of the allowance prior to the end of each calendar quarter. This assessment includes procedures to estimate the allowance and test the adequacy and appropriateness of the resulting balance. The level of the allowance is based upon management s evaluation of the loan portfolio, past loan loss experience, current asset quality trends, known and inherent risks in the portfolio, adverse situations that may affect the borrower s ability to

repay (including the timing of future payment), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, industry and peer bank loan quality indications and other pertinent factors, including regulatory recommendations. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. Loan losses are charged off when management believes that the full collectability of the loan is unlikely. A loan may be partially charged-off after a confirming event has occurred which serves to validate that full repayment pursuant to the terms of the loan is unlikely. Allocation of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management s judgment, is deemed to be uncollectible.

A loan is impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Collection of all amounts due according to the contractual terms means that both the interest and principal payments of a loan will be collected as scheduled in the loan agreement.

An impairment allowance is recognized if the fair value of the loan is less than the recorded investment in the loan (recorded investment in the loan is the principal balance plus any accrued interest, net of deferred loan fees or costs and unamortized premium or discount). The impairment is recognized through the allowance. Loans that are impaired are recorded at the present value of expected future cash flows discounted at the loan s effective interest rate, or if the loan is collateral dependent, impairment measurement is based on the fair value of the collateral, less estimated disposal costs. If the measure of the impaired loan is less than the recorded investment in the loan, the Company recognizes an impairment by creating a valuation allowance with a corresponding charge to the provision for loan losses or by adjusting an existing valuation allowance for the impaired loan with a corresponding charge or credit to the provision for loan losses. Management believes it follows appropriate accounting and regulatory guidance in determining impairment and accrual status of impaired loans.

The level of allowance maintained is believed by management to be adequate to absorb probable losses inherent in the portfolio at the balance sheet date. The allowance is increased by provisions charged to expense and decreased by charge-offs, net of recoveries of amounts previously charged-off.

In assessing the adequacy of the allowance, we also consider the results of our ongoing loan review process. We undertake this process both to ascertain whether there are loans in the portfolio whose credit quality has weakened over time and to assist in our overall evaluation of the risk characteristics of the entire loan portfolio. Our loan review process includes the judgment of management, the input from our independent loan reviewers, and reviews that may have been conducted by bank regulatory agencies as part of their usual examination process. We incorporate loan review results in the determination of whether or not it is probable that we will be able to collect all amounts due according to the contractual terms of a loan.

As part of management s quarterly assessment of the allowance, management divides the loan portfolio into twelve segments based on bank call reporting requirements. Each segment is then analyzed such that an allocation of the allowance is estimated for each loan segment.

The allowance allocation begins with a process of estimating the probable losses in each of the twelve loan segments. The estimates for these loans are based on our historical loss data for that category over the last twelve quarters.

The estimated loan loss allocation for all twelve loan portfolio segments is then adjusted for several environmental factors. The allocation for environmental factors is particularly subjective and does not lend itself to exact mathematical calculation. This amount represents estimated probable inherent credit losses which exist, but have not yet been identified, as of the balance sheet date, and are based upon quarterly trend assessments in delinquent and nonaccrual loans, unanticipated charge-offs, credit

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concentration changes, prevailing economic conditions, changes in lending personnel experience, changes in lending policies or procedures and other influencing factors. These environmental factors are considered for each of the twelve loan segments and the allowance allocation, as determined by the processes noted above for each component, is increased or decreased based on the incremental assessment of these various environmental factors.

We then test the resulting allowance by comparing the balance in the allowance to industry and peer information. Our management then evaluates the result of the procedures performed, including the result of our testing, and concludes on the appropriateness of the balance of the allowance in its entirety. The board of directors reviews and approves the assessment prior to the filing of quarterly and annual financial information.

Impairment of Intangible Assets. Long-lived assets, including purchased intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

Goodwill and intangible assets that have indefinite useful lives are evaluated for impairment annually and are evaluated for impairment more frequently if events and circumstances indicate that the asset might be impaired. That annual assessment date is December 31. An impairment loss is recognized to the extent that the carrying amount exceeds the asset s fair value. The Company first has the option to perform a qualitative assessment of goodwill to determine if impairment has occurred. Based upon the qualitative assessment, if the fair value of goodwill exceeds the carrying value, the evaluation of goodwill is complete. If the qualitative assessment indicates that impairment is present, the goodwill impairment analysis continues with a two-step test. The first step, used to identify potential impairment, involves comparing each reporting unit s estimated fair value to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment.

If required, the second step involves calculating an implied fair value of goodwill for each reporting unit for which the first step indicated potential impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. An impairment loss cannot exceed the carrying value of goodwill assigned to a reporting unit, and the loss establishes a new basis in the goodwill.

Other-than-temporary Impairment. A decline in the fair value of any available-for-sale or held-to-maturity security below cost that is deemed to be other-than-temporary results in a reduction in the carrying amount of the security. To determine whether impairment is other-than-temporary, management considers whether the entity expects to recover the entire amortized cost basis of the security by reviewing the present value of the future cash flows associated with the security. The shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis is referred to as a credit loss and is deemed to be other-than temporary impairment. If a credit loss is identified, the credit loss is recognized as a charge to earnings and a new cost basis for the security is established. If management concludes that no credit loss exists and it is not more-likely-than-not that the Company will be required to sell the security before maturity, then the security is not other-than-temporarily impaired and the shortfall is

recorded as a component of equity.

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Results of Operations

Net earnings increased 40.09% to $4,172,000 for the three months ended March 31, 2014 from $2,978,000 in the first three months of 2013. The increase in net earnings for the period ended March 31, 2014, compared to the same period in 2013, was related primarily to an increase in net interest income and a decrease in noninterest expense, offset in part by a decrease in noninterest income. Net yield on earning assets was 3.68% for the three months ended March 31, 2014 and 3.72% for the same period in 2013, and the net interest spread was 3.58% for the three months ended March 31, 2014 and 3.60% for the three months ended March 31, 2013. The reduction in yields on loans contributed to the decline in net yield on earning assets and net interest spread in first quarter of 2014 as compared to the comparable period in 2013.

The average balances, interest, and average rates for the three-month periods ended March 31, 2014 and March 31, 2013 are presented in the following table:

	March 31, 2014			**March 31, 2013**		
	Average Balance	Interest Rate	Income/ Expense	Average Balance	Interest Rate	Income/ Expense
Loans, net of unearned interest	$ 1,212,398	5.29%	16,043	$ 1,175,741	5.60%	16,464
Investment securities - taxable	340,656	1.88	1,600	307,030	1.38	1,059
Investment securities - tax exempt	29,497	2.22	164	26,004	2.25	146
Taxable equivalent adjustment		1.15	84		1.16	75
Total tax-exempt investment securities	29,497	3.37	248	26,004	3.41	221
Total investment securities	370,153	2.00	1,848	333,034	1.54	1,280
Loans held for sale	4,761	4.28	51	9,685	2.93	71
Federal funds sold	97,008	.19	46	94,861	.19	44
Restricted equity securities	3,012	3.98	30	3,012	4.78	36
Total earning assets	1,687,332	4.27%	18,018	1,616,333	4.43%	17,895
Cash and due from banks	10,704			10,092		
Allowance for loan losses	(23,141)			(26,791)		
Bank premises and equipment	38,498			35,882		
Other assets	49,800			44,822		
Total assets	$ 1,763,193			$ 1,680,338		

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	March 31, 2014			March 31, 2013		
	Average Balance	Interest Rate	Income/ Expense	Average Balance	Interest Rate	Income/ Expense
Deposits:						
Negotiable order of withdrawal accounts	$ 335,583	.47%	391	$ 305,866	.52%	396
Money market demand accounts	420,310	.44	464	353,819	.51	448
Individual retirement accounts	94,997	1.15	273	98,422	1.37	336
Other savings deposits	96,011	.57	136	96,281	.61	146
Certificates of deposit $100,000 and over	252,870	1.06	670	256,558	1.23	789
Certificates of deposit under $100,000	237,628	.95	565	258,929	1.12	725
Total interest-bearing deposits	1,437,399	.70	2,499	1,369,875	.83	2,840
Securities sold under repurchase agreements	7,751	.46	9	9,654	.54	13
Federal funds purchased				(9)		
Advances from Federal Home Loan Bank						
Total interest-bearing liabilities	1,445,150	.69	2,508	1,379,520	.83	2,853
Demand deposits	130,563			124,013		
Other liabilities	9,212			7,620		
Stockholders equity	178,268			169,185		
Total liabilities and stockholders equity	$ 1,763,193			$ 1,680,338		
Net interest income, on a tax equivalent basis			$ 15,510			$ 15,042
Net yield on earning assets (1)		3.68%			3.72%	
Net interest spread (2)		3.58%			3.60%	

(1) Net interest income divided by average interest-earning assets.

(2) Average interest rate on interest-earning assets less average interest rate on interest-bearing liabilities.

Net Interest Income

Net interest income represents the amount by which interest earned on various earning assets exceeds interest paid on deposits and other interest-bearing liabilities and is the most significant component of the Company s earnings. Reflecting a reduction in loan yields that outpaced loan growth and an increase in the yields on taxable securities, the Company s total interest income, excluding tax equivalent adjustments relating to tax exempt securities, increased $114,000, or 0.64%, during the three months ended March 31, 2014 as compared to the same period in 2013. The ratio of average earning assets to total average assets was 95.7% and 96.2% for the three months ended March 31, 2014 and March 31, 2013, respectively.

Interest expense decreased $345,000, or 12.09%, for the three months ended March 31, 2014 as compared to the same period in 2013. The decrease for the quarter ended March 31, 2014 as compared to the prior year s comparable period was primarily due to a decrease in the rates paid on deposits, particularly time deposits, reflecting the low interest rate environment and a shift in the mix of deposits from certificates of deposits to transaction and money market accounts. The increase in interest income and decrease in interest expense resulted in an increase in net interest income, before the provision for loan losses, of $459,000 to $15,426,000 for the first three months of 2014 as compared to $14,967,000 the same period in 2013.

Provision for Loan Losses

The allowance for loan losses totaled $23,325,000 as of March 31, 2014 compared to $22,935,000 as of December 31, 2013 and $25,845,000 as of March 31, 2013. An analytical model based on historical loss experience, current trends and economic conditions as well as reasonably foreseeable events is used to determine the amount of provision to be recognized and to test the adequacy of the loan loss allowance. The volume of net loans recovered for the first quarter of 2014 totaled approximately $142,000 compared to approximately $321,000 and $980,000 of net chargeoffs for the first quarters of 2013 and 2012, respectively. Overall, net charge offs were down for the quarter ended March 31, 2014 due to an overall improvement in the Bank s loan portfolio. Although the Bank has experienced modest loan growth of .70% and an overall stabilization in the loan portfolio, in accordance with the Bank s

quarterly allowance calculation management continues to fund the allowance for loan losses through general provisions. Reflecting the improving asset quality trends experienced by the Bank in the first quarter of 2014, the provision for loan losses during the quarter ended March 31, 2014 was $249,000, down $420,000 from the $669,000 incurred in the first quarter of 2013.

The allowance for loan losses is based on past loan experience and other factors which, in management s judgment, deserve current recognition in estimating possible loan losses. Such factors include growth and composition of the loan portfolio, review of specific problem loans, review of updated appraisals and borrower financial information, the recommendations of the Company s regulators, and current economic conditions that may affect the borrower s ability to repay. Management has in place a system designed for monitoring its loan portfolio and identifying potential problem loans. The provision for loan losses raised the allowance for loan losses (net of charge-offs and recoveries) to $23,325,000, an increase of 1.70% from $22,935,000 at December 31, 2013 and a decrease of $2,520,000, or 9.75%, from March 31, 2013. The allowance for loan losses was 1.92%, 1.90%, and 2.17% of total loans at March 31, 2014, December 31, 2013, and March 31, 2013, respectively.

Management believes the allowance for loan losses at March 31, 2014 to be adequate, but if economic conditions deteriorate beyond management s current expectations and additional charge-offs are incurred, the allowance for loan losses may require an increase through additional provision for loan losses which would negatively impact earnings.

Non-Interest Income

The components of the Company s non-interest income include service charges on deposit accounts, other fees and commissions and gain on sale of loans. Total non-interest income for the three months ended March 31, 2014 decreased 5.03% to $3,364,000 from $3,542,000 for the same period in 2013. The Company s non-interest income in the first three months of 2014 decreased from the first three months of 2013 in part due to a decrease in service charges on deposit accounts as well as a decrease in gain on the sale of loans, partially offset by an increase in other fees and commissions. Gain on sale of loans decreased $321,000, or 39.05%, to $501,000 during the three months ended March 31, 2014 compared to the same period in 2013, relating primarily to the increase in mortgage rates during the second half of 2013, which slowed consumer demand for refinancing current mortgages. Service charges on deposit accounts decreased $24,000, or 2.55%, to $916,000 during the three months ended March 31, 2014 compared to the same period in 2013 as a result of customers slowing their spending due to the weakened economy and the impact beginning in 2011 of changes to federal regulations related to service charges on ATM and point of sale debit card transactions. Other fees and commissions increased $167,000, or 9.38%, to $1,947,000 during the three months ended March 31, 2014 compared to the same period in 2013, relating primarily to an increase in brokerage income between the two time periods. Other fees and commissions include income on brokerage accounts, insurance policies sold, and various other fees.

Non-Interest Expenses

Non-interest expenses consist primarily of employee costs, occupancy expenses, furniture and equipment expenses, advertising and marketing expenses, FDIC premiums, data processing expenses, director s fees, loss on sale of other real estate, and other operating expenses. Total non-interest expenses decreased $1,361,000, or 10.49%, to $11,617,000 during the first three months of 2014 compared to the same period in 2013. The decrease in non-interest expenses for the three months ended March 31, 2014 when compared to the comparable period in 2013 is primarily attributable to a decrease in litigation expense. Loss on the sale of other real estate decreased $88,000, or 35.48%, for the three months ended March 31, 2014 as compared to the same period in 2013 due to a lower volume of foreclosures as well as improved economic conditions and an improved housing market.

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Income Taxes

The Company s income tax expense was $2,752,000 for the three months ended March 31, 2014, an increase of $868,000 over the comparable period in 2013. The percentage of income tax expense to net income before taxes was 39.75% and 38.75% for the three months ended March 31, 2014 and March 31, 2013, respectively.

Financial Condition

Balance Sheet Summary

The Company s total assets increased 3.03% to $1,802,037,000 during the three months ended March 31, 2014 from $1,748,971,000 at December 31, 2013. Loans, net of allowance for loan losses, totaled $1,192,359,000 at March 31, 2014, a 0.68% increase compared to $1,184,267,000 at December 31, 2013. Reflecting a deposit growth that outpaced the loan growth, securities increased $30,659,000, or 8.61%, to $386,855,000 at March 31, 2014 from $356,196,000 at December 31, 2013. Federal funds sold increased to $50,110,000 at March 31, 2014 from $38,190,000 at December 31, 2013.

Total liabilities increased by 3.08% to $1,619,652,000 at March 31, 2014 compared to $1,571,300,000 at December 31, 2013. The increase in total liabilities since December 31, 2013 was composed of a $46,959,000, or 3.02%, increase in total deposits and a $3,854,000, or 48.37%, increase in accrued interest and other liabilities. The increase in accrued interest and other liabilities is attributable to an increase in employee bonus payable as well as an increase in federal and state taxes payable.

Non Performing Assets

The following tables present the Company s non-accrual loans and past due loans as of March 31, 2014 and December 31, 2013.

Loans on Nonaccrual Status

	In Thousands	
	2014	2013
Residential 1-4 family	$ 498	726
Multifamily		
Commercial real estate		21
Construction	3,321	3,524
Farmland	700	700
Second mortgages	606	606
Equity lines of credit		
Commercial		
Agricultural, installment and other		
Total	$ 5,125	$ 5,577

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(In thousands)

	30-59 Days Past Due	60-89 Days Past Due	Non Accrual and Greater Than 90 Days	Total Non Accrual and Past Due	Current	Total Loans	Recorded Investment Greater Than 90 Days Past Due and Accruing
March 31, 2014							
Residential 1-4 family	$ 5,326	833	1,332	7,491	324,961	332,452	$ 834
Multifamily					17,946	17,946	
Commercial real estate	430		360	790	518,413	519,203	360
Construction	2,238	30	3,325	5,593	198,215	203,808	4
Farmland	97		700	797	26,335	27,132	
Second Mortgages	109		606	715	10,065	10,780	
Equity Lines of Credit	212		24	236	35,409	35,645	24
Commercial	49		480	529	27,650	28,179	480
Agricultural, installment and other	538	140	18	696	43,164	43,860	18
Total	$ 8,999	1,003	6,845	16,847	1,202,158	1,219,005	$ 1,720
December 31, 2013							
Residential 1-4 family	$ 5,034	221	1,582	6,837	325,595	332,432	$ 856
Multifamily					13,920	13,920	
Commercial real estate	287	19	710	1,016	525,242	526,258	689
Construction	948	20	3,795	4,763	189,663	194,426	271
Farmland	8		700	708	22,063	22,771	
Second Mortgages	78		611	689	9,822	10,511	5
Equity Lines of Credit	48	27		75	34,110	34,185	
Commercial	122		285	407	29,037	29,444	285
Agricultural, installment and other	484	115	27	626	45,882	46,508	27
Total	$ 7,009	402	7,710	15,121	1,195,334	1,210,455	$ 2,133

Generally, at the time a loan is placed on nonaccrual status, all interest accrued on the loan in the current fiscal year is reversed from income, and all interest accrued and uncollected from the prior year is charged off against the allowance for loan losses. Thereafter, interest on nonaccrual loans is recognized as interest income only to the extent that cash is received and future collection of principal is not in doubt. A nonaccrual loan may be restored to accruing status when principal and interest are no longer past due and unpaid and future collection of principal and interest on a timely basis

is not in doubt.

Non-performing loans, which included non-accrual loans and loans 90 days past due, at March 31, 2014 totaled $6,845,000, a decrease from $7,710,000 at December 31, 2013. The decrease in non-performing loans during the three months ended March 31, 2014 of $865,000 is due primarily to a decrease in non-performing construction real estate mortgage loans of $470,000 and a decrease in non-performing residential 1-4 family real estate loans of $250,000. Management believes that it is probable that it will incur losses on these loans but believes that these losses should not exceed the amount in the allowance for loan losses already allocated to these loans, unless there is further deterioration of local real estate values.

Other loans may be classified as impaired when the current net worth and financial capacity of the borrower or of the collateral pledged, if any, is viewed as inadequate. Such loans generally have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt, and if such deficiencies are not corrected, there is a probability that the Company will sustain some loss. In such cases, interest income continues to accrue as long as the loan does not meet the Company s criteria for nonaccrual status.

The reduction in impaired loans at March 31, 2014 when compared to December 31, 2013 was primarily due to multiple loan relationships becoming current. The Company s market areas have seen an increase in the residential real estate market and the commercial real estate market remains steady. The allowance for loan loss related to collateral dependent impaired loans was measured based upon the estimated fair value of related collateral.

Loans are charged-off in the month when the determination is made that the loan is uncollectible. Net recoveries for the three months ended March 31, 2014 were $142,000 as compared to $321,000 in net charge-offs for the three months ended March 31, 2013. The Bank has continued to experience a decrease in past dues and nonaccruals and is experiencing fewer foreclosures which has resulted in fewer charge offs.

The collateral values securing potential problem loans, including impaired loans, based on estimates received by management, total approximately $38,004,000. The internally classified loans have decreased $718,000, or 1.89%, from $37,952,000 at December 31, 2013 to $37,234,000. Loans are listed as classified when information obtained about possible credit problems of the borrower has prompted management to question the ability of the borrower to comply with the repayment terms of the loan agreement. The loan classifications do not represent or result from trends or uncertainties which management expects will materially impact future operating results, liquidity or capital resources.

The largest category of internally graded loans at March 31, 2014 was real estate mortgage loans. Included within this category are residential real estate construction and development loans, including loans to home builders and developers of land, as well as one-to-four family mortgage loans, and commercial real estate loans. Residential real estate loans, including construction and land development loans that are internally classified totaled $18,648,000 and $19,057,000 at March 31, 2014 and December 31, 2013, respectively. These loans have been graded accordingly due to bankruptcies, inadequate cash flows and delinquencies. Borrowers within the real estate related loans have continued to experience some stress during the current weak economic environment; however, the Bank has recently experienced an increase in demand for real estate loans. An extension of the challenging economic environment experienced since 2008 will likely cause the Company s commercial real estate mortgage and land development loans to continue to underperform and may result in increased levels of internally graded loans which, if they continue to deteriorate, may negatively impact the Company s results of operations. Management does not anticipate losses on residential real estate construction and development loans to exceed the amount already allocated to loan losses, unless there is further deterioration of local real estate values.

Liquidity and Asset Management

The Company s management seeks to maximize net interest income by managing the Company s assets and liabilities within appropriate constraints on capital, liquidity and interest rate risk. Liquidity is the ability to maintain sufficient cash levels necessary to fund operations, meet the requirements of depositors and borrowers, and fund attractive investment opportunities. Higher levels of liquidity bear corresponding costs, measured in terms of lower yields on short-term, more liquid earning assets and higher interest expense involved in extending liability maturities.

Liquid assets include cash and cash equivalents and investment securities and money market instruments that will mature within one year. At March 31, 2014, the Company s liquid assets totaled $317 million. The Company maintains a formal asset and liability management process to quantify, monitor and control interest rate risk and to assist management in maintaining stability in the net interest margin under varying interest rate environments. The Company accomplishes this process through the development and implementation of lending, funding and pricing strategies designed to maximize net interest income under varying interest rate environments subject to specific liquidity and interest rate risk guidelines.

Analysis of rate sensitivity and rate gap analysis are the primary tools used to assess the direction and magnitude of changes in net interest income resulting from changes in interest rates. Included in the analysis are cash flows and maturities of financial instruments held for purposes other than trading, changes in market conditions, loan volumes and pricing and deposit volume and mix. These assumptions are inherently uncertain, and, as a result, net interest income cannot be precisely estimated nor can the impact of higher or lower interest rates on net interest income be precisely predicted. Actual results will differ due to timing, magnitude and frequency of interest rate changes and changes in market conditions and management s strategies, among other factors.

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The Company s primary source of liquidity is a stable core deposit base. In addition, short-term borrowings, loan payments and investment security maturities provide a secondary source. At March 31, 2014, the Company had a liability sensitive position (a negative gap). Liability sensitivity means that more of the Company s liabilities are capable of re-pricing over certain time frames than its assets. The interest rates associated with these liabilities may not actually change over this period but are capable of changing.

Interest rate risk (sensitivity) management focuses on the earnings risk associated with changing interest rates. Management seeks to maintain profitability in both immediate and long-term earnings through funds management/interest rate risk management. The Company s rate sensitivity position has an important impact on earnings. Senior management of the Company meets monthly to analyze its rate sensitivity position. These meetings focus on the spread between the Company s cost of funds and interest yields generated primarily through loans and investments.

The Company s securities portfolio consists of earning assets that provide interest income. For those securities classified as held-to-maturity, the Company has the ability and intent to hold these securities to maturity or on a long-term basis. Securities classified as available-for-sale include securities intended to be used as part of the Company s asset/liability strategy and/or securities that may be sold in response to changes in interest rate, prepayment risk, the need or desire to increase capital and similar economic factors. Securities totaling approximately $5.1 million mature or will be subject to rate adjustments within the next twelve months.

A secondary source of liquidity is the Company s loan portfolio. At March 31, 2014, loans totaling approximately $264 million either will become due or will be subject to rate adjustments within twelve months from that date. Continued emphasis will be placed on structuring adjustable rate loans.

As for liabilities, certificates of deposit of $100,000 or greater totaling approximately $158 million will become due or reprice during the next twelve months. Historically, there has been no significant reduction in immediately withdrawable accounts such as negotiable order of withdrawal accounts, money market demand accounts, demand deposit accounts and regular savings accounts. Management anticipates that there will be no significant withdrawals from these accounts in the future.

Management believes that with present maturities, the anticipated growth in deposit base, and the efforts of management in its asset/liability management program, liquidity will not pose a problem in the near term future. At the present time there are no known trends or any known commitments, demands, events or uncertainties that will result in or that are reasonably likely to result in the Company s liquidity changing in a materially adverse way.

Off Balance Sheet Arrangements

At March 31, 2014, we had unfunded loan commitments outstanding of $225 million and outstanding standby letters of credit of $28 million. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements. If needed to fund these outstanding commitments, the Bank has the ability to liquidate Federal funds sold or securities available-for-sale or on a short-term basis to borrow and purchase Federal funds from other financial institutions. Additionally, the Bank could sell participations in these or other loans to correspondent banks. As mentioned above, the Bank has been able to fund its ongoing liquidity needs through its stable core deposit base, loan payments, its investment security maturities and short-term borrowings.

Capital Position and Dividends

At March 31, 2014, total stockholders equity was $182,385,000, or 10.12% of total assets, which compares with $177,671,000, or 10.16% of total assets, at December 31, 2013. The dollar increase in stockholders equity during the three months ended March 31, 2014 results from the Company s net income of $4,172,000, proceeds from the issuance of common stock related to exercise of stock options of $81,000, the net effect of a $1,920,000 unrealized gain on investment securities net of applicable income taxes of $735,000, cash dividends declared of $2,250,000 of which $1,607,000 was reinvested under the Company s dividend reinvestment plan, the $94,000 repurchase of common stock and $13,000 related to stock option compensation.

The Company s and the Bank s principal regulators have established minimum risk-based capital requirements and leverage capital requirements for the Company and the Bank. These guidelines classify capital into two categories of Tier I and Total risk-based capital. Total risk-based capital consists of Tier I (or core) capital (essentially common equity less intangible assets) and Tier II capital (essentially qualifying long-term debt, of which the Bank has none, and a part of the allowance for possible loan losses). In determining risk-based capital requirements, assets are assigned risk-weights of 0% to 100%, depending on regulatory assigned levels of credit risk associated with such assets. Under the Federal Reserve s regulations, for a bank holding company, like the Company, to be considered well capitalized it must maintain a total risk-based capital ratio of at least 10%, a Tier 1 risk-based capital ratio of at least 6% and not be subject to a written agreement, order or directive to maintain a specific capital level. In addition, the Federal Reserve has established minimum leverage ratio guidelines for bank holding companies. These guidelines provide that a minimum ratio of Tier 1 capital to average assets, less goodwill and other specified intangible assets, of at least 4% should be maintained by most bank holding companies.

In July 2013, the Federal Reserve and the FDIC approved final rules that substantially amend the regulatory risk-based capital rules applicable to the Company and the Bank. The final rules implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. Under these rules, the leverage and risk-based capital ratios of bank holding companies may not be lower than the leverage and risk-based capital ratios for insured depository institutions. The final rules implementing the Basel III regulatory capital reforms will become effective as to the Company and the Bank on January 1, 2015 and include new minimum risk-based capital and leverage ratios. Moreover, these rules refine the definition of what constitutes capital for purposes of calculating those ratios. The new minimum capital level requirements applicable to bank holding companies and banks subject to the rules are: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 risk-based capital ratio of 6% (increased from 4%); (iii) a total risk-based capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4% for all institutions. The rules also establish a capital conservation buffer of 2.5% (to be phased in over three years) above the new regulatory minimum capital ratios, and result in the following minimum ratios once the capital conservation buffer is fully phased in: (i) a common equity Tier 1 risk-based capital ratio of 7.0%, (ii) a Tier 1 risk-based capital ratio of 8.5%, and (iii) a total risk-based capital ratio of 10.5%. The capital conservation buffer requirement is to be phased in beginning in January 2016 at 0.625% of risk-weighted assets and would increase each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases and paying discretionary bonuses if its capital levels fall below the buffer amounts. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

The application of these more stringent capital requirements to the Company and the Bank could, among other things, result in lower returns on invested capital, require the raising of additional capital, and result in regulatory actions if the Company and the Bank were to be unable to comply with such requirements. Furthermore, the imposition of liquidity requirements in connection with the implementation of the final rules regarding Basel III could result in the Company or the Bank having to lengthen the term of their funding, restructure their business models and/or increase their holdings of liquid assets. Implementation of changes to asset risk weightings for risk-based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital

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conservation buffers could result in management modifying its business strategy and could limit the Company s and the Bank s ability to make distributions, including paying dividends or buying back shares.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). As of March 31, 2014 and December 31, 2013, the Company and the Bank are considered to be well-capitalized under current regulatory definitions. To be categorized as well-capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables.

The Company s and the Bank s actual capital amounts and ratios as of March 31, 2014 and December 31, 2013, are also presented in the tables:

	Actual		*Minimum Capital Requirement*		*Minimum To Be Well Capitalized Under Applicable Regulatory Provisions*	
	Amount	*Ratio*	*Amount*	*Ratio*	*Amount*	*Ratio*
			(dollars in thousands)			
March 31, 2014:						
Total capital to risk weighted assets:						
Consolidated	$ 197,476	14.8%	$ 106,888	8.0%	$ 133,610	10.0%
Wilson Bank	195,369	14.6	106,905	8.0	133,631	10.0
Tier 1 capital to risk weighted assets:						
Consolidated	180,690	13.5	53,459	4.0	80,188	6.0
Wilson Bank	178,583	13.4	53,428	4.0	80,142	6.0
Tier 1 capital to average assets:						
Consolidated	180,690	10.3	70,103	4.0	87,629	5.0
Wilson Bank	178,583	10.2	70,101	4.0	87,627	5.0

	Actual		*Minimum Capital Requirement*		*Minimum To Be Well Capitalized Under Applicable Regulatory Provisions*	
	Amount	*Ratio*	*Amount*	*Ratio*	*Amount*	*Ratio*
			(dollars in thousands)			
December 31, 2013:						
Total capital to risk weighted assets:						
Consolidated	$ 193,746	14.7%	$ 105,656	8.0%	$ 132,070	10.0%
Wilson Bank	190,911	14.5	105,622	8.0	132,027	10.0
Tier 1 capital to risk weighted assets:						
Consolidated	177,161	13.4	52,805	4.0	79,208	6.0
Wilson Bank	174,326	13.2	52,826	4.0	79,239	6.0
Tier 1 capital to average assets:						
Consolidated	177,161	10.3	69,001	4.0	N/A	N/A
Wilson Bank	174,326	10.1	69,040	4.0	86,300	5.0

Impact of Inflation

Although interest rates are significantly affected by inflation, the inflation rate is immaterial when reviewing the Company s results of operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company s primary component of market risk is interest rate volatility. Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on a large portion of the Company s assets and liabilities, and the market value of all interest-earning assets and interest-bearing liabilities, other than those which possess a short term to maturity. Based upon the nature of the Company s operations, the Company is not subject to foreign currency exchange or commodity price risk.

Interest rate risk (sensitivity) management focuses on the earnings risk associated with changing interest rates. Management seeks to maintain profitability in both short-term and long-term earnings through funds management/interest rate risk management. The Company s rate sensitivity position has an important impact on earnings. Senior management of the Company meets monthly to analyze the rate sensitivity position. These meetings focus on the spread between the cost of funds and interest yields generated primarily through loans and investments.

There have been no material changes in reported market risks during the three months ended March 31, 2014.

Item 4. Controls and Procedures

The Company maintains disclosure controls and procedures, as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934 (the Exchange Act), that are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and that such information is accumulated and communicated to the Company s management, including its Chief Executive Officer and its Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. The Company carried out an evaluation, under the supervision and with the participation of its

management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures as of the end of the period covered by this report. Based on the evaluation of these disclosure controls and procedures, its Chief Executive Officer and its Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective.

There were no changes in the Company s internal control over financial reporting during the Company s fiscal quarter ended March 31, 2014 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

Not applicable

Item 1A. RISK FACTORS

There were no material changes to the Company s risk factors as previously disclosed in Part I, Item 1A of the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) None

(b) Not applicable.

(c) The table below sets forth the number of shares repurchased by the registrant during the first quarter of 2014 and the average prices at which these shares were repurchased.

	Total Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased under the Plans or Programs
January 1 - January 31, 2014	1,545	$ 45.75		
February 1 February 28, 2014	508	$ 45.75		
March 1 March 31, 2014				

Item 3. DEFAULTS UPON SENIOR SECURITIES

(a) None

(b) Not applicable

Item 4. MINE SAFETY DISCLOSURES

Not applicable

Item 5. OTHER INFORMATION

None

Item 6. EXHIBITS

31.1 Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

WILSON BANK HOLDING COMPANY
(Registrant)

DATE:	May 8, 2014	/s/ Randall Clemons Randall Clemons President and Chief Executive Officer
DATE:	May 8, 2014	/s/ Lisa Pominski Lisa Pominski Senior Vice President & Chief Financial Officer

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