

CNB FINANCIAL CORP/PA  
Form 10-Q  
November 07, 2013  
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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 quarterly period ended September 30, 2013

or

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 000-13396

**CNB FINANCIAL CORPORATION**

(Exact name of registrant as specified in its charter)

**Pennsylvania**  
(State or other jurisdiction of  
incorporation or organization)

**25-1450605**  
(I.R.S. Employer  
Identification No.)

**1 South Second Street**

**P.O. Box 42**

**Clearfield, Pennsylvania 16830**

(Address of principal executive offices)

**Registrant's telephone number, including area code, (814) 765-9621**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate 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).  Yes  No

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

The number of shares outstanding of the issuer's common stock as of November 4, 2013

COMMON STOCK NO PAR VALUE PER SHARE: 14,388,078 SHARES

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**FINANCIAL INFORMATION**

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### **Forward-Looking Statements**

This document contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, with respect to our financial condition, liquidity, results of operations, future performance and business. These forward-looking statements are intended to be covered by the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are those that are not historical facts. Forward-looking statements include statements with respect to beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions that are subject to significant risks and uncertainties and are subject to change based on various factors (some of which are beyond our control). Forward-looking statements often include words such as believes, expects, anticipates, estimates, intends, plans or similar expressions or future conditional verbs such as may, will, should, would and could. Such known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from the statements include, but are not limited to: changes in general business, industry or economic conditions or competition; changes in any applicable law, rule, regulation, policy, guideline or practice governing or affecting financial holding companies and their subsidiaries or with respect to tax or accounting principles or otherwise; adverse changes or conditions in capital and financial markets; changes in interest rates; higher than expected costs or other difficulties related to integration of combined or merged businesses; the inability to realize expected cost savings or achieve other anticipated benefits in connection with business combinations and other acquisitions, including the previously announced acquisition of FC Banc Corp.; changes in the quality or composition of our loan and investment portfolios; adequacy of loan loss reserves; increased competition; loss of certain key officers; continued relationships with major customers; deposit attrition; rapidly changing technology; unanticipated regulatory or judicial proceedings and liabilities and other costs; changes in the cost of funds, demand for loan products or demand for financial services; and other economic, competitive, governmental or technological factors affecting our operations, markets, products, services and prices. Some of these and other factors are discussed in our annual and quarterly reports filed with the Securities and Exchange Commission. Such factors could cause actual results to differ materially from those in the forward-looking statements.

The forward-looking statements are based upon management's beliefs and assumptions and are made as of the date of the filing of this document. We undertake no obligation to publicly update or revise any forward-looking statements included in this document or to update the reasons why actual results could differ from those contained in such statements, whether as a result of new information, future events or otherwise, except to the extent required by law. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this document might not occur and you should not put undue reliance on any forward-looking statements.

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## Part I Financial Information

## Item 1. Financial Statements

## CONSOLIDATED BALANCE SHEETS

Dollars in thousands, except share data

|                                                                                                       | (unaudited)<br>September 30,<br>2013 | December 31,<br>2012 |
|-------------------------------------------------------------------------------------------------------|--------------------------------------|----------------------|
| <b><u>ASSETS</u></b>                                                                                  |                                      |                      |
| Cash and due from banks                                                                               | \$ 28,756                            | \$ 28,570            |
| Interest bearing deposits with other banks                                                            | 4,100                                | 3,311                |
| Total cash and cash equivalents                                                                       | 32,856                               | 31,881               |
| Interest bearing time deposits with other banks                                                       | 275                                  | 225                  |
| Securities available for sale                                                                         | 700,531                              | 737,311              |
| Trading securities                                                                                    | 4,358                                | 4,459                |
| Loans held for sale                                                                                   | 399                                  | 2,398                |
| Loans                                                                                                 | 1,032,875                            | 931,225              |
| Less: unearned discount                                                                               | (3,904)                              | (3,401)              |
| Less: allowance for loan losses                                                                       | (17,221)                             | (14,060)             |
| Net loans                                                                                             | 1,011,750                            | 913,764              |
| FHLB and other equity interests                                                                       | 7,580                                | 6,684                |
| Premises and equipment, net                                                                           | 26,042                               | 24,072               |
| Bank owned life insurance                                                                             | 29,739                               | 27,645               |
| Mortgage servicing rights                                                                             | 696                                  | 714                  |
| Goodwill                                                                                              | 10,946                               | 10,946               |
| Accrued interest receivable and other assets                                                          | 12,247                               | 12,980               |
| <b>TOTAL</b>                                                                                          | <b>\$ 1,837,419</b>                  | <b>\$ 1,773,079</b>  |
| <b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>                                                    |                                      |                      |
| Non-interest bearing deposits                                                                         | \$ 189,362                           | \$ 175,239           |
| Interest bearing deposits                                                                             | 1,362,919                            | 1,309,764            |
| Total deposits                                                                                        | 1,552,281                            | 1,485,003            |
| FHLB and other borrowings                                                                             | 122,976                              | 97,806               |
| Subordinated debentures                                                                               | 20,620                               | 20,620               |
| Accrued interest payable and other liabilities                                                        | 10,776                               | 24,286               |
| Total liabilities                                                                                     | 1,706,653                            | 1,627,715            |
| Common stock, \$0 par value; authorized 50,000,000<br>shares; issued 12,599,603 shares                | 0                                    | 0                    |
| Additional paid in capital                                                                            | 44,065                               | 44,223               |
| Retained earnings                                                                                     | 94,718                               | 88,960               |
| Treasury stock, at cost (85,465 shares at September 30, 2013 and 123,699 shares at December 31, 2012) | (1,179)                              | (1,743)              |
| Accumulated other comprehensive income (loss)                                                         | (6,838)                              | 13,924               |

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|                           |                     |                     |
|---------------------------|---------------------|---------------------|
| Total shareholders equity | 130,766             | 145,364             |
| <b>TOTAL</b>              | <b>\$ 1,837,419</b> | <b>\$ 1,773,079</b> |

See Notes to Consolidated Financial Statements

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## CONSOLIDATED STATEMENTS OF INCOME (unaudited)

Dollars in thousands, except per share data

|                                                                                                                                                                                                    | Three months ended<br>September 30, |               |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------|---------------|
|                                                                                                                                                                                                    | 2013                                | 2012          |
| <b>INTEREST AND DIVIDEND INCOME:</b>                                                                                                                                                               |                                     |               |
| Loans including fees                                                                                                                                                                               | \$ 13,153                           | \$ 12,574     |
| <b>Securities:</b>                                                                                                                                                                                 |                                     |               |
| Taxable                                                                                                                                                                                            | 3,283                               | 3,651         |
| Tax-exempt                                                                                                                                                                                         | 969                                 | 892           |
| Dividends                                                                                                                                                                                          | 60                                  | 16            |
| <b>Total interest and dividend income</b>                                                                                                                                                          | <b>17,465</b>                       | <b>17,133</b> |
| <b>INTEREST EXPENSE:</b>                                                                                                                                                                           |                                     |               |
| Deposits                                                                                                                                                                                           | 1,673                               | 2,424         |
| Borrowed funds                                                                                                                                                                                     | 949                                 | 834           |
| Subordinated debentures (includes \$102 and \$98 accumulated other comprehensive income reclassification for change in fair value of interest rate swap agreements in 2013 and 2012, respectively) | 195                                 | 205           |
| <b>Total interest expense</b>                                                                                                                                                                      | <b>2,817</b>                        | <b>3,463</b>  |
| <b>NET INTEREST INCOME</b>                                                                                                                                                                         | <b>14,648</b>                       | <b>13,670</b> |
| <b>PROVISION FOR LOAN LOSSES</b>                                                                                                                                                                   | <b>846</b>                          | <b>1,188</b>  |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>                                                                                                                                         | <b>13,802</b>                       | <b>12,482</b> |
| <b>NON-INTEREST INCOME:</b>                                                                                                                                                                        |                                     |               |
| Wealth and asset management fees                                                                                                                                                                   | 615                                 | 498           |
| Service charges on deposit accounts                                                                                                                                                                | 1,102                               | 1,049         |
| Other service charges and fees                                                                                                                                                                     | 607                                 | 467           |
| Net realized gains on available-for-sale securities (includes \$103 accumulated other comprehensive income reclassifications for net realized gains on available-for-sale securities in 2012)      | 0                                   | 103           |
| Net realized and unrealized gains on trading securities                                                                                                                                            | 166                                 | 275           |
| Mortgage banking                                                                                                                                                                                   | 107                                 | 225           |
| Bank owned life insurance                                                                                                                                                                          | 365                                 | 229           |
| Other                                                                                                                                                                                              | 286                                 | 233           |
| <b>Total non-interest income</b>                                                                                                                                                                   | <b>3,248</b>                        | <b>3,079</b>  |
| <b>NON-INTEREST EXPENSES:</b>                                                                                                                                                                      |                                     |               |
| Salaries and benefits                                                                                                                                                                              | 5,288                               | 4,831         |
| Net occupancy expense                                                                                                                                                                              | 1,234                               | 1,138         |
| Data processing                                                                                                                                                                                    | 890                                 | 700           |
| State and local taxes                                                                                                                                                                              | 391                                 | 369           |
| Legal, professional, and examination fees                                                                                                                                                          | 313                                 | 411           |
| Advertising                                                                                                                                                                                        | 205                                 | 250           |
| FDIC insurance premiums                                                                                                                                                                            | 332                                 | 283           |
| Merger costs                                                                                                                                                                                       | 398                                 | 0             |

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|                                                                                                                            |                 |                 |
|----------------------------------------------------------------------------------------------------------------------------|-----------------|-----------------|
| Other                                                                                                                      | 1,292           | 1,226           |
| Total non-interest expenses                                                                                                | 10,343          | 9,208           |
| <b>INCOME BEFORE INCOME TAXES</b>                                                                                          | <b>6,707</b>    | <b>6,353</b>    |
| INCOME TAX EXPENSE (includes (\$36) and \$2 income tax expense from reclassification items in 2013 and 2012, respectively) | 2,004           | 1,790           |
| <b>NET INCOME</b>                                                                                                          | <b>\$ 4,703</b> | <b>\$ 4,563</b> |
| <b>EARNINGS PER SHARE:</b>                                                                                                 |                 |                 |
| Basic                                                                                                                      | \$ 0.38         | \$ 0.37         |
| Diluted                                                                                                                    | \$ 0.38         | \$ 0.37         |
| <b>DIVIDENDS PER SHARE:</b>                                                                                                |                 |                 |
| Cash dividends per share                                                                                                   | \$ 0.165        | \$ 0.165        |

See Notes to Consolidated Financial Statements



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## CONSOLIDATED STATEMENTS OF INCOME (unaudited)

Dollars in thousands, except per share data

|                                                                                                                                                                                                                                  | Nine months ended<br>September 30, |               |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------|---------------|
|                                                                                                                                                                                                                                  | 2013                               | 2012          |
| <b>INTEREST AND DIVIDEND INCOME:</b>                                                                                                                                                                                             |                                    |               |
| Loans including fees                                                                                                                                                                                                             | \$ 37,736                          | \$ 37,223     |
| <b>Securities:</b>                                                                                                                                                                                                               |                                    |               |
| Taxable                                                                                                                                                                                                                          | 10,166                             | 11,226        |
| Tax-exempt                                                                                                                                                                                                                       | 2,891                              | 2,668         |
| Dividends                                                                                                                                                                                                                        | 134                                | 47            |
| <b>Total interest and dividend income</b>                                                                                                                                                                                        | <b>50,927</b>                      | <b>51,164</b> |
| <b>INTEREST EXPENSE:</b>                                                                                                                                                                                                         |                                    |               |
| Deposits                                                                                                                                                                                                                         | 5,862                              | 8,519         |
| Borrowed funds                                                                                                                                                                                                                   | 2,557                              | 2,418         |
| Subordinated debentures (includes \$304 and \$290 accumulated other comprehensive income reclassification for change in fair value of interest rate swap agreements in 2013 and 2012, respectively)                              | 583                                | 606           |
| <b>Total interest expense</b>                                                                                                                                                                                                    | <b>9,002</b>                       | <b>11,543</b> |
| <b>NET INTEREST INCOME</b>                                                                                                                                                                                                       | <b>41,925</b>                      | <b>39,621</b> |
| <b>PROVISION FOR LOAN LOSSES</b>                                                                                                                                                                                                 | <b>4,891</b>                       | <b>4,038</b>  |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>                                                                                                                                                                       | <b>37,034</b>                      | <b>35,583</b> |
| <b>NON-INTEREST INCOME:</b>                                                                                                                                                                                                      |                                    |               |
| Wealth and asset management fees                                                                                                                                                                                                 | 1,727                              | 1,311         |
| Service charges on deposit accounts                                                                                                                                                                                              | 3,063                              | 3,020         |
| Other service charges and fees                                                                                                                                                                                                   | 1,561                              | 1,367         |
| Net realized gains on available-for-sale securities (includes \$328 and \$1,400 accumulated other comprehensive income reclassifications for net realized gains on available-for-sale securities in 2013 and 2012, respectively) | 328                                | 1,400         |
| Net realized and unrealized gains on trading securities                                                                                                                                                                          | 497                                | 455           |
| Mortgage banking                                                                                                                                                                                                                 | 633                                | 686           |
| Bank owned life insurance                                                                                                                                                                                                        | 1,442                              | 752           |
| Other                                                                                                                                                                                                                            | 839                                | 767           |
| <b>Total non-interest income</b>                                                                                                                                                                                                 | <b>10,090</b>                      | <b>9,758</b>  |
| <b>NON-INTEREST EXPENSES:</b>                                                                                                                                                                                                    |                                    |               |
| Salaries and benefits                                                                                                                                                                                                            | 15,817                             | 14,175        |
| Net occupancy expense                                                                                                                                                                                                            | 3,832                              | 3,394         |
| Data processing                                                                                                                                                                                                                  | 2,455                              | 2,118         |
| State and local taxes                                                                                                                                                                                                            | 1,266                              | 1,098         |
| Legal, professional, and examination fees                                                                                                                                                                                        | 966                                | 968           |
| Advertising                                                                                                                                                                                                                      | 697                                | 750           |
| FDIC insurance premiums                                                                                                                                                                                                          | 930                                | 816           |
| Merger costs                                                                                                                                                                                                                     | 1,329                              | 0             |

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|                                                                                                                           |                  |                  |
|---------------------------------------------------------------------------------------------------------------------------|------------------|------------------|
| Other                                                                                                                     | 3,526            | 3,736            |
| Total non-interest expenses                                                                                               | 30,818           | 27,055           |
| <b>INCOME BEFORE INCOME TAXES</b>                                                                                         | <b>16,306</b>    | <b>18,286</b>    |
| INCOME TAX EXPENSE (includes \$8 and \$389 income tax expense from reclassification items in 2013 and 2012, respectively) | 4,355            | 5,040            |
| <b>NET INCOME</b>                                                                                                         | <b>\$ 11,951</b> | <b>\$ 13,246</b> |
| <b>EARNINGS PER SHARE:</b>                                                                                                |                  |                  |
| Basic                                                                                                                     | \$ 0.96          | \$ 1.07          |
| Diluted                                                                                                                   | \$ 0.96          | \$ 1.06          |
| <b>DIVIDENDS PER SHARE:</b>                                                                                               |                  |                  |
| Cash dividends per share                                                                                                  | \$ 0.495         | \$ 0.495         |

See Notes to Consolidated Financial Statements

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## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (unaudited)

Dollars in thousands

|                                                                                                                                                                                                                                      | Three months ended<br>September 30, |                 | Nine months ended<br>September 30, |                  |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------|-----------------|------------------------------------|------------------|
|                                                                                                                                                                                                                                      | 2013                                | 2012            | 2013                               | 2012             |
| <b>NET INCOME</b>                                                                                                                                                                                                                    | <b>\$ 4,703</b>                     | <b>\$ 4,563</b> | <b>\$ 11,951</b>                   | <b>\$ 13,246</b> |
| Other comprehensive income (loss), net of tax:                                                                                                                                                                                       |                                     |                 |                                    |                  |
| Net change in fair value of interest rate swap agreements designated as cash flow hedges:                                                                                                                                            |                                     |                 |                                    |                  |
| Unrealized gain (loss) on interest rate swaps, net of tax of \$31 and \$58 for the three months ended September 30, 2013 and 2012, and (\$69) and \$164 for the nine months ended September 30, 2013 and 2012                        | (58)                                | (108)           | 129                                | (305)            |
| Reclassification adjustment for losses recognized in earnings, net of tax of (\$36) and (\$34) for the three months ended September 30, 2013 and 2012, and (\$106) and (\$101) for the nine months ended September 30, 2013 and 2012 | 66                                  | 64              | 198                                | 189              |
|                                                                                                                                                                                                                                      | 8                                   | (44)            | 327                                | (116)            |
| Net change in unrealized gains on securities available for sale:                                                                                                                                                                     |                                     |                 |                                    |                  |
| Unrealized gains (losses) on other-than-temporarily impaired securities available for sale:                                                                                                                                          |                                     |                 |                                    |                  |
| Unrealized gains arising during the period, net of tax of (\$51) for the three months ended September 30, 2013, and (\$62) and (\$7) for the nine months ended September 30, 2013 and 2012                                           | 95                                  | 0               | 114                                | 13               |
| Unrealized gains (losses) on other securities available for sale:                                                                                                                                                                    |                                     |                 |                                    |                  |
| Unrealized gains (losses) arising during the period, net of tax of \$1,676 and (\$611) for the three months ended September 30, 2013 and 2012, and \$11,302 and (\$2,419) for the nine months ended September 30, 2013 and 2012      | (3,113)                             | 1,134           | (20,990)                           | 4,493            |
| Reclassification adjustment for realized gains included in net income, net of tax of \$36 for the three months ended September 30, 2012, and \$115 and \$490 for the nine months ended September 30, 2013 and 2012                   | 0                                   | (67)            | (213)                              | (910)            |
|                                                                                                                                                                                                                                      | (3,113)                             | 1,067           | (21,203)                           | 3,583            |
| Other comprehensive income (loss)                                                                                                                                                                                                    | (3,010)                             | 1,023           | (20,762)                           | 3,480            |
| <b>COMPREHENSIVE INCOME (LOSS)</b>                                                                                                                                                                                                   | <b>\$ 1,693</b>                     | <b>\$ 5,586</b> | <b>\$ (8,811)</b>                  | <b>\$ 16,726</b> |

See Notes to Consolidated Financial Statements

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## CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

Dollars in thousands

|                                                                                                                    | Nine months ended<br>September 30, |                  |
|--------------------------------------------------------------------------------------------------------------------|------------------------------------|------------------|
|                                                                                                                    | 2013                               | 2012             |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                                                       |                                    |                  |
| Net income                                                                                                         | \$ 11,951                          | \$ 13,246        |
| Adjustments to reconcile net income to net cash provided by operations:                                            |                                    |                  |
| Provision for loan losses                                                                                          | 4,891                              | 4,038            |
| Depreciation and amortization of premises and equipment                                                            | 1,632                              | 1,582            |
| Amortization and accretion of securities premiums and discounts, deferred loan fees and costs, and unearned income | 2,756                              | 3,353            |
| Net realized gains on sales of available-for-sale securities                                                       | (328)                              | (1,400)          |
| Net realized and unrealized gains on trading securities                                                            | (497)                              | (455)            |
| Proceeds from sale of trading securities                                                                           | 4,424                              | 2,625            |
| Purchase of trading securities                                                                                     | (3,803)                            | (2,699)          |
| Gain on sale of loans                                                                                              | (556)                              | (640)            |
| Net gains on dispositions of premises and equipment and foreclosed assets                                          | (151)                              | (120)            |
| Proceeds from sale of loans                                                                                        | 19,889                             | 21,674           |
| Origination of loans held for sale                                                                                 | (17,484)                           | (23,524)         |
| Income on bank owned life insurance                                                                                | (1,442)                            | (752)            |
| Stock-based compensation expense                                                                                   | 290                                | 205              |
| Contribution of treasury stock                                                                                     | 90                                 | 90               |
| Changes in:                                                                                                        |                                    |                  |
| Accrued interest receivable and other assets                                                                       | (3,606)                            | (1,998)          |
| Accrued interest payable and other liabilities                                                                     | (1,941)                            | 710              |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>                                                                   | <b>16,115</b>                      | <b>15,935</b>    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                                                       |                                    |                  |
| Net decrease in interest bearing time deposits with other banks                                                    | (50)                               | (1)              |
| Proceeds from maturities, prepayments and calls of securities                                                      | 86,708                             | 82,288           |
| Proceeds from sales of securities                                                                                  | 33,672                             | 92,707           |
| Purchase of securities                                                                                             | (114,748)                          | (252,561)        |
| Loan origination and payments, net                                                                                 | (102,600)                          | (62,860)         |
| Purchase of bank owned life insurance                                                                              | (2,000)                            | (1,000)          |
| Proceeds from death benefits associated with bank owned life insurance                                             | 1,348                              | 0                |
| Acquisition of consumer discount company                                                                           | 0                                  | (1,248)          |
| Purchase of FHLB and other equity interests                                                                        | (896)                              | (218)            |
| Purchase of premises and equipment                                                                                 | (3,434)                            | (1,711)          |
| Proceeds from the sale of premises and equipment and foreclosed assets                                             | 579                                | 867              |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>                                                                       | <b>(101,421)</b>                   | <b>(143,737)</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                                                       |                                    |                  |
| Net change in:                                                                                                     |                                    |                  |
| Checking, money market and savings accounts                                                                        | 93,805                             | 174,031          |
| Certificates of deposit                                                                                            | (26,527)                           | (47,612)         |
| Proceeds from sale of treasury stock                                                                               | 2                                  | 528              |
| Proceeds from exercise of stock options                                                                            | 24                                 | 374              |

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|                                                             |                  |                  |
|-------------------------------------------------------------|------------------|------------------|
| Cash dividends paid                                         | (6,193)          | (6,156)          |
| Proceeds from long-term borrowings                          | 900              | 0                |
| Repayment of long-term borrowings                           | (145)            | (120)            |
| Net change in short-term borrowings                         | 24,415           | 0                |
| <b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>            | <b>86,281</b>    | <b>121,045</b>   |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b> | <b>975</b>       | <b>(6,757)</b>   |
| <b>CASH AND CASH EQUIVALENTS, Beginning</b>                 | <b>31,881</b>    | <b>39,703</b>    |
| <b>CASH AND CASH EQUIVALENTS, Ending</b>                    | <b>\$ 32,856</b> | <b>\$ 32,946</b> |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>    |                  |                  |
| Cash paid during the period for:                            |                  |                  |
| Interest                                                    | \$ 9,134         | \$ 11,807        |
| Income taxes                                                | \$ 3,646         | \$ 5,418         |
| <b>SUPPLEMENTAL NONCASH DISCLOSURES:</b>                    |                  |                  |
| Transfers to other real estate owned                        | \$ 333           | \$ 680           |
| Grant of restricted stock awards from treasury stock        | \$ 539           | \$ 419           |
| Contribution of treasury stock                              | \$ 90            | \$ 90            |

See Notes to Consolidated Financial Statements

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**CNB FINANCIAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**1. BASIS OF PRESENTATION**

The accompanying consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission ( SEC ) and in compliance with accounting principles generally accepted in the United States of America ( GAAP ). Because this report is based on an interim period, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted.

In the opinion of management of the registrant, the accompanying consolidated financial statements as of September 30, 2013 and for the three and nine month periods ended September 30, 2013 and 2012 include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial condition and the results of operations for the periods presented. The financial performance reported for CNB Financial Corporation (the Corporation ) for the three and nine month periods ended September 30, 2013 is not necessarily indicative of the results to be expected for the full year. This information should be read in conjunction with the Corporation s Annual Report on Form 10-K for the period ended December 31, 2012 (the 2012 Form 10-K ). All dollar amounts are stated in thousands, except share and per share data and other amounts as indicated.

**2. SUBSEQUENT EVENT - ACQUISITION OF FC BANC CORP.**

In the first quarter of 2013, the Corporation announced the signing of a definitive merger agreement to acquire 100% of the outstanding equity interests of FC Banc Corp. and its subsidiary, The Farmers Citizens Bank ( FC Bank ), for \$30.00 per share in cash and stock. FC Bank serves the northern Ohio markets of Bucyrus, Cardington, Fredericktown, Mount Hope and Shiloh, as well as the markets of Worthington and Upper Arlington in the greater Columbus, Ohio area, with 8 branch locations. The transaction closed on October 11, 2013 and resulted in consideration paid to FC Banc Corp. shareholders totaling approximately \$41.6 million, comprised of approximately \$8.0 million in cash and 1,873,879 shares of the Corporation s common stock valued at approximately \$33.6 million based on the October 11, 2013 closing price of \$17.91 per share.

The Corporation s management and board of directors have periodically conducted strategic reviews as part of their ongoing efforts to improve the Corporation s banking franchise and enhance shareholder value. In connection with these strategic reviews, the Corporation has considered potential acquisition targets, including banking institutions in Ohio. On March 26, 2013, the Corporation s board of directors unanimously approved the merger transaction with FC Banc Corp. and authorized the Corporation s management to execute and deliver the merger agreement.

As disclosed in the accompanying consolidated statements of income, the Corporation incurred merger costs of \$398 thousand and \$1.3 million for the three and nine months ended September 30, 2013. All merger costs have been expensed as incurred.

As of the date that the Corporation s third quarter 2013 consolidated financial statements are issued, all of the information required to be disclosed by Accounting Standards Codification No. 805 was not available since, given the short period between the October 11, 2013 acquisition date and the financial statement issuance, the calculation of the fair value of all material FC Banc Corp. assets acquired and liabilities assumed had not yet been completed.

**Table of Contents****3. STOCK COMPENSATION**

The Corporation has a stock incentive plan for key employees and independent directors. The stock incentive plan, which is administered by a committee of the Board of Directors, provides for aggregate grants of up to 500,000 shares of common stock in the form of nonqualified options or restricted stock. For key employees, the plan vesting is one-fourth of the granted options or restricted stock per year beginning one year after the grant date, with 100% vested on the fourth anniversary of the grant. For independent directors, the vesting schedule is one-third of the granted options per year beginning one year after the grant date, with 100% vested on the third anniversary of the grant.

At September 30, 2013, there was no unrecognized compensation cost related to nonvested stock options granted under this plan and no stock options were granted during the three or nine month periods ended September 30, 2013 and 2012. At September 30, 2013 and December 31, 2012, the Corporation had 74,203 and 75,500 stock options, respectively, that were fully vested and exercisable.

Compensation expense for the restricted stock awards is recognized over the requisite service period noted above based on the fair value of the shares at the date of grant. Nonvested restricted stock awards are recorded as a reduction of additional paid-in-capital in shareholders' equity until earned. Compensation expense resulting from these restricted stock awards was \$104 and \$290 for the three and nine months ended September 30, 2013, and \$73 and \$205 for the three and nine months ended September 30, 2012. As of September 30, 2013, there was \$784 of total unrecognized compensation cost related to unvested restricted stock awards.

A summary of changes in nonvested restricted stock awards for the three months ended September 30, 2013 follows:

|                                  |        | Per Share                              |       |
|----------------------------------|--------|----------------------------------------|-------|
|                                  | Shares | Weighted Average Grant Date Fair Value |       |
| Nonvested at beginning of period | 65,400 | \$                                     | 16.24 |
| Granted                          | 0      |                                        | 0     |
| Vested                           | (200)  |                                        | 15.29 |
| Nonvested at end of period       | 65,200 | \$                                     | 16.24 |

A summary of changes in nonvested restricted stock awards for the nine months ended September 30, 2013 follows:

|                                  |          | Per Share                              |       |
|----------------------------------|----------|----------------------------------------|-------|
|                                  | Shares   | Weighted Average Grant Date Fair Value |       |
| Nonvested at beginning of period | 49,574   | \$                                     | 15.37 |
| Granted                          | 31,500   |                                        | 17.10 |
| Vested                           | (15,874) |                                        | 15.23 |
| Nonvested at end of period       | 65,200   | \$                                     | 16.24 |

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### **4. FAIR VALUE**

#### **Fair Value Measurement**

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A fair value hierarchy has also been established which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following three levels of inputs are used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of most trading securities and securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). The fair value of one corporate bond held by the Corporation has been determined by using Level 3 inputs. The Corporation has engaged a valuation expert to price this security using a proprietary model which incorporates assumptions about certain factors that market participants would use in pricing the securities, including bid/ask spreads and liquidity and credit premiums.

The Corporation's structured pooled trust preferred security is priced using Level 3 inputs. The decline in the level of observable inputs and market activity in this class of investments by the measurement date has been significant and resulted in unreliable external pricing. Broker pricing and bid/ask spreads, when available, vary widely, and the once-active market has become comparatively inactive. The Corporation engaged a third party consultant who has developed a model for pricing this security. Information such as historical and current performance of the underlying collateral, deferral and default rates, collateral coverage ratios, break in yield calculations, cash flow projections, liquidity and credit premiums required by a market participant, and financial trend analysis with respect to the individual issuing financial institutions and insurance companies are utilized in determining the security valuation. Due to the current market conditions as well as the limited trading activity of these types of securities, the market value of the Corporation's structured pooled trust preferred security is highly sensitive to assumption changes and market volatility.

The Corporation's derivative instrument is an interest rate swap that is similar to those that trade in liquid markets. As such, significant fair value inputs can generally be verified and do not typically involve significant management judgments (Level 2 inputs).



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Assets and liabilities measured at fair value on a recurring basis are as follows at September 30, 2013 and December 31, 2012:

| Description                                | Total             | Fair Value Measurements at September 30, 2013 Using                        |                                                        |                                                    |
|--------------------------------------------|-------------------|----------------------------------------------------------------------------|--------------------------------------------------------|----------------------------------------------------|
|                                            |                   | Quoted Prices in<br>Active Markets for<br>Identical<br>Assets<br>(Level 1) | Significant Other<br>Observable<br>Inputs (Level<br>2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Assets:</b>                             |                   |                                                                            |                                                        |                                                    |
| <b>Securities Available For Sale:</b>      |                   |                                                                            |                                                        |                                                    |
| U.S. Treasury                              | \$ 2,007          | \$ 0                                                                       | \$ 2,007                                               | \$ 0                                               |
| U.S. Government sponsored entities         | 177,230           | 0                                                                          | 177,230                                                | 0                                                  |
| States and political subdivisions          | 179,863           | 0                                                                          | 179,863                                                | 0                                                  |
| Residential and multi-family mortgage      | 255,039           | 0                                                                          | 255,039                                                | 0                                                  |
| Commercial mortgage                        | 950               | 0                                                                          | 950                                                    | 0                                                  |
| Corporate notes and bonds                  | 14,157            | 0                                                                          | 14,157                                                 | 0                                                  |
| Pooled trust preferred                     | 776               | 0                                                                          | 0                                                      | 776                                                |
| Pooled SBA                                 | 69,513            | 69,513                                                                     | 0                                                      | 0                                                  |
| Other securities                           | 996               | 996                                                                        | 0                                                      | 0                                                  |
| <b>Total Securities Available For Sale</b> | <b>\$ 700,531</b> | <b>\$ 70,509</b>                                                           | <b>\$ 629,246</b>                                      | <b>\$ 776</b>                                      |
| <b>Trading Securities:</b>                 |                   |                                                                            |                                                        |                                                    |
| Corporate equity securities                | \$ 2,998          | \$ 2,998                                                                   | \$ 0                                                   | \$ 0                                               |
| Certificates of deposit                    | 253               | 253                                                                        | 0                                                      | 0                                                  |
| International mutual funds                 | 257               | 257                                                                        | 0                                                      | 0                                                  |
| Large cap growth mutual funds              | 182               | 182                                                                        | 0                                                      | 0                                                  |
| Large cap value mutual funds               | 121               | 121                                                                        | 0                                                      | 0                                                  |
| Real estate investment trust mutual funds  | 40                | 40                                                                         | 0                                                      | 0                                                  |
| Corporate notes and bonds                  | 152               | 0                                                                          | 152                                                    | 0                                                  |
| Mid cap mutual funds                       | 81                | 81                                                                         | 0                                                      | 0                                                  |
| Small cap mutual funds                     | 81                | 81                                                                         | 0                                                      | 0                                                  |
| U.S. Government sponsored entities         | 53                | 0                                                                          | 53                                                     | 0                                                  |
| Commodities mutual funds                   | 54                | 54                                                                         | 0                                                      | 0                                                  |
| Money market mutual funds                  | 86                | 86                                                                         | 0                                                      | 0                                                  |
| <b>Total Trading Securities</b>            | <b>\$ 4,358</b>   | <b>\$ 4,153</b>                                                            | <b>\$ 205</b>                                          | <b>\$ 0</b>                                        |
| <b>Liabilities:</b>                        |                   |                                                                            |                                                        |                                                    |
| Interest rate swaps                        | \$ (1,241)        | \$ 0                                                                       | \$ (1,241)                                             | \$ 0                                               |

| Description                           | Total    | Fair Value Measurements at December 31, 2012 Using                            |                                                     |                                                    |
|---------------------------------------|----------|-------------------------------------------------------------------------------|-----------------------------------------------------|----------------------------------------------------|
|                                       |          | Quoted Prices<br>in<br>Active Markets for<br>Identical<br>Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Assets:</b>                        |          |                                                                               |                                                     |                                                    |
| <b>Securities Available For Sale:</b> |          |                                                                               |                                                     |                                                    |
| U.S. Treasury                         | \$ 4,036 | \$ 0                                                                          | \$ 4,036                                            | \$ 0                                               |
| U.S. Government sponsored entities    | 163,781  | 0                                                                             | 163,781                                             | 0                                                  |
| States and political subdivisions     | 181,279  | 0                                                                             | 181,279                                             | 0                                                  |

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|                                       |            |           |            |          |
|---------------------------------------|------------|-----------|------------|----------|
| Residential and multi-family mortgage | 316,822    | 0         | 316,822    | 0        |
| Commercial mortgage                   | 1,304      | 0         | 1,304      | 0        |
| Corporate notes and bonds             | 15,024     | 0         | 13,044     | 1,980    |
| Pooled trust preferred                | 600        | 0         | 0          | 600      |
| Pooled SBA                            | 52,927     | 52,631    | 296        | 0        |
| Other securities                      | 1,538      | 1,538     | 0          | 0        |
| Total Securities Available For Sale   | \$ 737,311 | \$ 54,169 | \$ 680,562 | \$ 2,580 |

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|                                           |                 |                 |               |             |
|-------------------------------------------|-----------------|-----------------|---------------|-------------|
| <b>Trading Securities:</b>                |                 |                 |               |             |
| Corporate equity securities               | \$ 3,117        | \$ 3,117        | \$ 0          | \$ 0        |
| Certificates of deposit                   | 408             | 408             | 0             | 0           |
| International mutual funds                | 287             | 287             | 0             | 0           |
| Large cap growth mutual funds             | 157             | 157             | 0             | 0           |
| Money market mutual funds                 | 110             | 110             | 0             | 0           |
| Large cap value mutual funds              | 104             | 104             | 0             | 0           |
| Corporate notes and bonds                 | 101             | 0               | 101           | 0           |
| Real estate investment trust mutual funds | 65              | 65              | 0             | 0           |
| U.S. Government sponsored entities        | 58              | 0               | 58            | 0           |
| Small cap mutual funds                    | 26              | 26              | 0             | 0           |
| Mid cap mutual funds                      | 26              | 26              | 0             | 0           |
| <b>Total Trading Securities</b>           | <b>\$ 4,459</b> | <b>\$ 4,300</b> | <b>\$ 159</b> | <b>\$ 0</b> |

**Liabilities:**

|                     |            |      |            |      |
|---------------------|------------|------|------------|------|
| Interest rate swaps | \$ (1,745) | \$ 0 | \$ (1,745) | \$ 0 |
|---------------------|------------|------|------------|------|

The table below presents a reconciliation and income statement classification of gains and losses for all securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended September 30, 2013:

|                                                             |                              |
|-------------------------------------------------------------|------------------------------|
|                                                             | Pooled<br>trust<br>preferred |
| Balance, July 1, 2013                                       | \$ 630                       |
| Total gains or (losses):                                    |                              |
| Included in other comprehensive income                      | 146                          |
| Included in realized gains on available-for-sale securities | 0                            |
| Sale of available-for-sale securities                       | 0                            |
| Balance, September 30, 2013                                 | \$ 776                       |

The table below presents a reconciliation and income statement classification of gains and losses for all securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine months ended September 30, 2013:

|                                                             |                                 |                              |
|-------------------------------------------------------------|---------------------------------|------------------------------|
|                                                             | Corporate<br>notes and<br>bonds | Pooled<br>trust<br>preferred |
| Balance, January 1, 2013                                    | \$ 1,980                        | \$ 600                       |
| Total gains or (losses):                                    |                                 |                              |
| Included in other comprehensive income                      | (29)                            | 176                          |
| Included in realized gains on available-for-sale securities | 58                              | 0                            |
| Sale of available-for-sale securities                       | (2,009)                         | 0                            |
| Balance, September 30, 2013                                 | \$ 0                            | \$ 776                       |

The table below presents a reconciliation and income statement classification of gains and losses for all securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended September 30, 2012:

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|                                                     | Corporate<br>notes and<br>bonds | Pooled<br>trust<br>preferred |
|-----------------------------------------------------|---------------------------------|------------------------------|
| Balance, July 1, 2012                               | \$ 2,071                        | \$ 360                       |
| Total gains or losses:                              |                                 |                              |
| Included in other comprehensive income (unrealized) | (86)                            | 0                            |
| Balance, September 30, 2012                         | \$ 1,985                        | \$ 360                       |

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The table below presents a reconciliation and income statement classification of gains and losses for all securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine months ended September 30, 2012:

|                                                     | Corporate notes and bonds | Pooled trust preferred |
|-----------------------------------------------------|---------------------------|------------------------|
| Balance, January 1, 2012                            | \$ 2,060                  | \$ 340                 |
| Total gains or losses:                              |                           |                        |
| Included in other comprehensive income (unrealized) | (75)                      | 20                     |
| Balance, September 30, 2012                         | \$ 1,985                  | \$ 360                 |

The following table presents quantitative information about Level 3 fair value measurements at September 30, 2013:

|                        | Fair value | Valuation Technique  | Unobservable Inputs                                  | Input Utilized                                                                                                                                                            |
|------------------------|------------|----------------------|------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Pooled trust preferred | \$ 776     | Discounted cash flow | Collateral default rate<br>Yield<br>Prepayment speed | 2% in 2013; 1.5% in 2014; 1.0% in 2015; 0.5% in 2016 and thereafter<br>12%<br>6.7% constant prepayment rate in 2013; 2.0% constant prepayment rate in 2014 and thereafter |

The following table presents quantitative information about Level 3 fair value measurements at December 31, 2012:

|                           | Fair value | Valuation Technique  | Unobservable Inputs                                                 | Input Utilized                                                          |
|---------------------------|------------|----------------------|---------------------------------------------------------------------|-------------------------------------------------------------------------|
| Corporate notes and bonds | \$ 1,980   | Discounted cash flow | Constant prepayment rate<br>Probability of default<br>Discount rate | 0%<br>0%<br>9.6%                                                        |
| Pooled trust preferred    | \$ 600     | Discounted cash flow | Collateral default rate<br>Yield<br>Recovery probability            | 2% annually for 2 years; 0.36% thereafter<br>13%<br>10%, lagged 2 years |

At September 30, 2013, the significant unobservable inputs used in the fair value measurement of the Corporation's pooled trust preferred security are collateral default rate, yield, and prepayment speed. At December 31, 2012, the significant unobservable inputs used in the fair value measurement of the Corporation's pooled trust preferred security are collateral default rate, yield, and recovery probability. Significant increases in specific-issuer default assumptions or decreases in specific-issuer recovery assumptions would result in a significantly lower fair value measurement. Conversely, decreases in specific-issuer default assumptions or increases in specific-issuer recovery assumptions would result in a

higher fair value measurement.

During the three months ended September 30, 2012, residential mortgage and asset backed securities totaling \$3,148 that were reported as Level 1 securities as of the beginning of the period were transferred to the Level 2 category. There were no transfers of securities from Level 1 to Level 2 during the three months ended September 30, 2013.

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During the nine months ended September 30, 2013 and 2012, the following available for sale securities reported as Level 1 securities as of the beginning of the period were transferred to the Level 2 category:

|                                       | 2013        | 2012             |
|---------------------------------------|-------------|------------------|
| U.S. Government sponsored entities    | \$ 0        | \$ 2,000         |
| States and political subdivisions     | 0           | 4,655            |
| Residential mortgage and asset backed | 0           | 8,577            |
| <b>Total</b>                          | <b>\$ 0</b> | <b>\$ 15,232</b> |

These securities were transferred from the Level 1 category to the Level 2 category since there were no longer quoted prices for identical assets in active markets that the Corporation had the ability to access. There were no transfers from the Level 2 category to the Level 1 category during the three or nine month periods ended September 30, 2013 or 2012. The Corporation's policy for determining when a transfer between the Level 1 and Level 2 categories has occurred is to monitor and report such transfers as of each quarterly reporting period.

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals prepared by third-parties. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Management also adjusts appraised values based on the length of time that has passed since the appraisal date and other factors. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Assets and liabilities measured at fair value on a non-recurring basis are as follows at September 30, 2013 and December 31, 2012:

| Description                              | Total    | Fair Value Measurements at September 30, 2013 Using Quoted Prices in Active Markets for |                                               |                                           |
|------------------------------------------|----------|-----------------------------------------------------------------------------------------|-----------------------------------------------|-------------------------------------------|
|                                          |          | Identical Assets (Level 1)                                                              | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Assets:</b>                           |          |                                                                                         |                                               |                                           |
| <b>Impaired loans:</b>                   |          |                                                                                         |                                               |                                           |
| Commercial mortgages                     | \$ 7,474 | \$ 0                                                                                    | \$ 0                                          | \$ 7,474                                  |
| Commercial, industrial, and agricultural | 1,200    | 0                                                                                       | 0                                             | 1,200                                     |
| Residential real estate                  | 64       | 0                                                                                       | 0                                             | 64                                        |

| Description                              | Total    | Fair Value Measurements at December 31, 2012 Using Quoted Prices in Active Markets for |                                               |                                           |
|------------------------------------------|----------|----------------------------------------------------------------------------------------|-----------------------------------------------|-------------------------------------------|
|                                          |          | Identical Assets (Level 1)                                                             | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Assets:</b>                           |          |                                                                                        |                                               |                                           |
| <b>Impaired loans:</b>                   |          |                                                                                        |                                               |                                           |
| Commercial mortgages                     | \$ 8,422 | \$ 0                                                                                   | \$ 0                                          | \$ 8,422                                  |
| Commercial, industrial, and agricultural | 1,973    | 0                                                                                      | 0                                             | 1,973                                     |
| Residential real estate                  | 402      | 0                                                                                      | 0                                             | 402                                       |

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Impaired loans, which are measured for impairment using the fair value of collateral for collateral dependent loans, had a recorded investment of \$12,143 with a valuation allowance of \$3,405 as of September 30, 2013, resulting in an additional provision for loan losses of \$704 and \$3,233 for the corresponding three and nine months ended September 30, 2013. Impaired loans had a recorded investment of \$12,535 with a valuation allowance of \$1,738 as of December 31, 2012, and an additional provision for loan losses of \$756 and \$1,544 was recorded for the three and nine months ended September 30, 2012.



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The estimated fair values of impaired collateral dependent loans such as commercial or residential mortgages are determined primarily through third-party appraisals. When a collateral dependent loan, such as a commercial or residential mortgage loan, becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal, and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral and a further reduction for estimated costs to sell the property is applied, which results in an amount that is considered to be the estimated fair value. If a loan becomes impaired and the appraisal of related loan collateral is outdated, management applies an appropriate adjustment factor based on its experience with current valuations of similar collateral in determining the loan's estimated fair value and resulting allowance for loan losses. Third-party appraisals are not customarily obtained in respect of unimpaired loans, unless in management's view changes in circumstances warrant obtaining an updated appraisal.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at September 30, 2013:

|                |                                          | Fair value | Valuation Technique       | Unobservable Inputs                                     | Range (Weighted Average) |
|----------------|------------------------------------------|------------|---------------------------|---------------------------------------------------------|--------------------------|
| Impaired loans | commercial mortgages                     | \$ 7,473   | Sales comparison approach | Adjustment for differences between the comparable sales | 9% - 10% (10%)           |
| Impaired loans | commercial, industrial, and agricultural | 1,200      | Income approach           | Adjustment for differences in net operating income      | 13% - 32% (23%)          |
| Impaired loans | residential real estate                  | 64         | Sales comparison approach | Adjustment for differences between the comparable sales | 17% - 26% (23%)          |

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2012:

|                |                                          | Fair value | Valuation Technique       | Unobservable Inputs                                     | Range (Weighted Average) |
|----------------|------------------------------------------|------------|---------------------------|---------------------------------------------------------|--------------------------|
| Impaired loans | commercial mortgages                     | \$ 8,422   | Sales comparison approach | Adjustment for differences between the comparable sales | 1% - 39% (19%)           |
| Impaired loans | commercial, industrial, and agricultural | 1,973      | Income approach           | Adjusting for differences in net operating income       | 24% - 38% (27%)          |
| Impaired loans | residential real estate                  | 402        | Sales comparison approach | Adjustment for differences between the comparable sales | 10% - 15% (11%)          |

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The following table presents the carrying amount and fair value of financial instruments at September 30, 2013:

|                                                 | Carrying Amount | Fair Value Measurement Using: |              |           | Total Fair Value |
|-------------------------------------------------|-----------------|-------------------------------|--------------|-----------|------------------|
|                                                 |                 | Level 1                       | Level 2      | Level 3   |                  |
| <b>ASSETS</b>                                   |                 |                               |              |           |                  |
| Cash and cash equivalents                       | \$ 32,856       | \$ 32,856                     | \$ 0         | \$ 0      | \$ 32,856        |
| Interest bearing time deposits with other banks | 275             | 0                             | 281          | 0         | 281              |
| Securities available for sale                   | 700,531         | 70,509                        | 629,246      | 776       | 700,531          |
| Trading securities                              | 4,358           | 4,153                         | 205          | 0         | 4,358            |
| Loans held for sale                             | 399             | 0                             | 410          | 0         | 410              |
| Net loans                                       | 1,011,750       | 0                             | 0            | 1,008,375 | 1,008,375        |
| FHLB and other equity interests                 | 7,580           | n/a                           | n/a          | n/a       | n/a              |
| Accrued interest receivable                     | 7,267           | 429                           | 3,827        | 3,011     | 7,267            |
| <b>LIABILITIES</b>                              |                 |                               |              |           |                  |
| Deposits                                        | \$ (1,552,281)  | \$ (1,365,864)                | \$ (186,041) | \$ 0      | \$ (1,551,905)   |
| FHLB and other borrowings                       | (122,976)       | 0                             | (122,976)    | 0         | (122,976)        |
| Subordinated debentures                         | (20,620)        | 0                             | (10,945)     | 0         | (10,945)         |
| Interest rate swaps                             | (1,241)         | 0                             | (1,241)      | 0         | (1,241)          |
| Accrued interest payable                        | (805)           | (200)                         | (590)        | (15)      | (805)            |

The following table presents the carrying amount and fair value of financial instruments at December 31, 2012:

|                                                 | Carrying Amount | Fair Value Measurement Using: |              |         | Total Fair Value |
|-------------------------------------------------|-----------------|-------------------------------|--------------|---------|------------------|
|                                                 |                 | Level 1                       | Level 2      | Level 3 |                  |
| <b>ASSETS</b>                                   |                 |                               |              |         |                  |
| Cash and cash equivalents                       | \$ 31,881       | \$ 31,881                     | \$ 0         | \$ 0    | \$ 31,881        |
| Interest bearing time deposits with other banks | 225             | 0                             | 230          | 0       | 230              |
| Securities available for sale                   | 737,311         | 54,169                        | 680,562      | 2,580   | 737,311          |
| Trading securities                              | 4,459           | 4,300                         | 159          | 0       | 4,459            |
| Loans held for sale                             | 2,398           | 0                             | 2,460        | 0       | 2,460            |
| Net loans                                       | 913,764         | 0                             | 0            | 917,785 | 917,785          |
| FHLB and other equity interests                 | 6,684           | n/a                           | n/a          | n/a     | n/a              |
| Accrued interest receivable                     | 6,863           | 278                           | 3,498        | 3,087   | 6,863            |
| <b>LIABILITIES</b>                              |                 |                               |              |         |                  |
| Deposits                                        | \$ (1,485,003)  | \$ (1,272,060)                | \$ (215,485) | \$ 0    | \$ (1,487,545)   |
| FHLB and other borrowings                       | (97,806)        | 0                             | (105,850)    | 0       | (105,850)        |
| Subordinated debentures                         | (20,620)        | 0                             | (10,682)     | 0       | (10,682)         |
| Interest rate swaps                             | (1,745)         | 0                             | (1,745)      | 0       | (1,745)          |
| Accrued interest payable                        | (1,022)         | (301)                         | (707)        | (14)    | (1,022)          |

The methods and assumptions, not otherwise presented, used to estimate fair values are described as follows:

**Cash and cash equivalents:** The carrying amounts of cash and cash equivalents approximate fair values and are classified as Level 1.

**Interest bearing time deposits with other banks:** The fair value of interest bearing time deposits with other banks is estimated using a discounted cash flow calculation that applies interest rates currently being offered to a schedule of aggregated expected monthly maturities, resulting in a Level 2 classification.

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**Loans held for sale:** The fair value of loans held for sale is estimated based upon binding contracts and quotes from third party investors resulting in a Level 2 classification.

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

**FHLB and other equity interests:** It is not practical to determine the fair value of Federal Home Loan Bank stock and other equity interests due to restrictions placed on the transferability of these instruments.

**Accrued interest receivable:** The carrying amount of accrued interest receivable approximates fair value resulting in a classification that is consistent with the asset with which it is associated.

**Deposits:** The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amount), resulting in a Level 1 classification. Fair values for time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits, resulting in a Level 2 classification.

**FHLB and other borrowings:** The fair values of the Corporation's FHLB and other borrowings are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements, resulting in a Level 2 classification.

**Subordinated debentures:** The fair value of the Corporation's subordinated debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of arrangements, resulting in a Level 3 classification.

**Accrued interest payable:** The carrying amount of accrued interest payable approximates fair value resulting in a classification that is consistent with the liability with which it is associated.

While estimates of fair value are based on management's judgment of the most appropriate factors as of the balance sheet date, there is no assurance that the estimated fair values would have been realized if the assets had been disposed of or the liabilities settled at that date, since market values may differ depending on various circumstances. The estimated fair values would also not apply to subsequent dates.

In addition, other assets and liabilities that are not financial instruments, such as premises and equipment, are not included in the disclosures. Also, non-financial assets such as, among other things, the estimated earnings power of core deposits, the earnings potential of trust accounts, the trained workforce, and customer goodwill, which typically are not recognized on the balance sheet, may have value but are not included in the fair value disclosures.

**5. SECURITIES**

Securities available for sale at September 30, 2013 and December 31, 2012 are as follows:

|                                     | September 30, 2013 |                     |                      |               | December 31, 2012 |                     |                      |               |
|-------------------------------------|--------------------|---------------------|----------------------|---------------|-------------------|---------------------|----------------------|---------------|
|                                     | Amortized<br>Cost  | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value |
| U.S. Treasury                       | \$ 2,003           | \$ 4                | \$ 0                 | \$ 2,007      | \$ 4,018          | \$ 18               | \$ 0                 | \$ 4,036      |
| U.S. Gov't sponsored entities       | 179,875            | 3,175               | (5,820)              | 177,230       | 157,965           | 5,977               | (161)                | 163,781       |
| State & political subdivisions      | 177,503            | 4,416               | (2,056)              | 179,863       | 170,223           | 11,113              | (57)                 | 181,279       |
| Residential & multi-family mortgage | 258,466            | 2,945               | (6,372)              | 255,039       | 308,800           | 8,724               | (702)                | 316,822       |
| Commercial mortgage                 | 971                | 0                   | (21)                 | 950           | 1,275             | 29                  | 0                    | 1,304         |
| Corporate notes & bonds             | 15,741             | 56                  | (1,640)              | 14,157        | 17,368            | 26                  | (2,370)              | 15,024        |
| Pooled trust preferred              | 800                | 0                   | (24)                 | 776           | 800               | 0                   | (200)                | 600           |

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|                  |            |           |             |            |            |           |            |            |
|------------------|------------|-----------|-------------|------------|------------|-----------|------------|------------|
| Pooled SBA       | 71,924     | 652       | (3,063)     | 69,513     | 50,667     | 2,277     | (17)       | 52,927     |
| Other securities | 1,020      | 0         | (24)        | 996        | 1,521      | 17        | 0          | 1,538      |
| Total            | \$ 708,303 | \$ 11,248 | \$ (19,020) | \$ 700,531 | \$ 712,637 | \$ 28,181 | \$ (3,507) | \$ 737,311 |

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At September 30, 2013, there were no holdings of securities of any one issuer, other than the U.S. Government sponsored entities, in an amount greater than 10% of shareholders' equity. The Corporation's residential and multi-family mortgage securities are issued by government sponsored entities, and the Corporation holds one commercial mortgage security that is private label.

Trading securities at September 30, 2013 and December 31, 2012 are as follows:

|                                           | September 30,<br>2013 | December 31,<br>2012 |
|-------------------------------------------|-----------------------|----------------------|
| Corporate equity securities               | \$ 2,998              | \$ 3,117             |
| Certificates of deposit                   | 253                   | 408                  |
| International mutual funds                | 257                   | 287                  |
| Large cap growth mutual funds             | 182                   | 157                  |
| Large cap value mutual funds              | 121                   | 104                  |
| Real estate investment trust mutual funds | 40                    | 65                   |
| Corporate notes and bonds                 | 152                   | 101                  |
| Mid cap mutual funds                      | 81                    | 26                   |
| Small cap mutual funds                    | 81                    | 26                   |
| U.S. Government sponsored entities        | 53                    | 58                   |
| Commodities mutual funds                  | 54                    | 0                    |
| Money market mutual funds                 | 86                    | 110                  |
| <b>Total</b>                              | <b>\$ 4,358</b>       | <b>\$ 4,459</b>      |

Securities with unrealized losses at September 30, 2013 and December 31, 2012, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows (in thousands):

**September 30, 2013**

|                                     | Less than 12 Months |                 | 12 Months or More |                 | Total      |                 |
|-------------------------------------|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
|                                     | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. Treasury                       | \$ 0                | \$ 0            | \$ 0              | \$ 0            | \$ 0       | \$ 0            |
| U.S. Gov't sponsored entities       | 110,419             | (5,820)         | 0                 | 0               | 110,419    | (5,820)         |
| State & political subdivisions      | 58,955              | (2,047)         | 474               | (9)             | 59,429     | (2,056)         |
| Residential & multi-family mortgage | 157,880             | (6,201)         | 5,124             | (171)           | 163,004    | (6,372)         |
| Commercial mortgage                 | 950                 | (21)            | 0                 | 0               | 950        | (21)            |
| Corporate notes & bonds             | 0                   | 0               | 9,754             | (1,640)         | 9,754      | (1,640)         |
| Pooled trust preferred              | 0                   | 0               | 776               | (24)            | 776        | (24)            |
| Pooled SBA                          | 40,735              | (2,933)         | 1,802             | (130)           | 42,537     | (3,063)         |
| Other securities                    | 996                 | (24)            | 0                 | 0               | 996        | (24)            |
|                                     | \$ 369,935          | \$ (17,046)     | \$ 17,930         | \$ (1,974)      | \$ 387,865 | \$ (19,020)     |

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|                                     | Less than 12 Months |                 | 12 Months or More |                 | Total      |                 |
|-------------------------------------|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
|                                     | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. Treasury                       | \$ 0                | \$ 0            | \$ 0              | \$ 0            | \$ 0       | \$ 0            |
| U.S. Gov t sponsored entities       | 41,715              | (161)           | 0                 | 0               | 41,715     | (161)           |
| State & political subdivisions      | 7,857               | (57)            | 0                 | 0               | 7,857      | (57)            |
| Residential & multi-family mortgage | 32,159              | (688)           | 4,254             | (14)            | 36,413     | (702)           |
| Commercial mortgage                 | 0                   | 0               | 0                 | 0               | 0          | 0               |
| Corporate notes & bonds             | 0                   | 0               | 13,002            | (2,370)         | 13,002     | (2,370)         |
| Pooled trust preferred              | 0                   | 0               | 600               | (200)           | 600        | (200)           |
| Pooled SBA                          | 3,521               | (17)            | 0                 | 0               | 3,521      | (17)            |
| Other securities                    | 0                   | 0               | 0                 | 0               | 0          | 0               |
|                                     | \$ 85,252           | \$ (923)        | \$ 17,856         | \$ (2,584)      | \$ 103,108 | \$ (3,507)      |

The Corporation evaluates securities for other-than-temporary impairment on a quarterly basis, or more frequently when economic or market conditions warrant such an evaluation.

At September 30, 2013, the Corporation held one structured pooled trust preferred security with an adjusted amortized cost of \$800 and a fair value of \$776. The Corporation evaluated this security for other-than-temporary impairment by estimating the cash flows expected to be received, taking into account future estimated levels of deferrals and defaults by the underlying issuers, and discounting those cash flows at the appropriate accounting yield. For the three and nine months ended September 30, 2013 and 2012, no other-than-temporary impairment was required to be realized in earnings. At September 30, 2013 and December 31, 2012, the Corporation held four structured pooled trust preferred securities with an adjusted amortized cost and fair value of zero.

A roll-forward of the other-than-temporary impairment amount related to credit losses for the three and nine months ended September 30, 2013 and 2012 is as follows:

|                                                                                                                                                    |          |
|----------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in earnings, beginning of period | \$ 4,054 |
| Additional credit loss for which other-than-temporary impairment was not previously recognized                                                     | 0        |
| Additional credit loss for which other-than-temporary impairment was previously recognized                                                         | 0        |
| Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in earnings, end of period       | \$ 4,054 |

Due to the insignificance of the adjusted amortized cost balance, no further disclosures are required with respect to the Corporation's structured pooled trust preferred securities.

For the securities that comprise corporate notes and bonds and the securities that are issued by state and political subdivisions, management monitors publicly available financial information, such as filings with the Securities and Exchange Commission, in order to evaluate the securities for other-than-temporary impairment. For financial institution issuers, management monitors information from quarterly call report filings that are used to generate Uniform Bank Performance Reports. All other securities that were in an unrealized loss position at the balance sheet date were reviewed by management, and issuer-specific documents were reviewed, as appropriate given the following considerations. When reviewing securities for other-than-temporary impairment, management considers the financial condition and near-term prospects of the issuer and whether downgrades by bond rating agencies have occurred. Management also considers the length of time and extent to which fair value has been less than cost, and management does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery.

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As of September 30, 2013 and December 31, 2012, management concluded that the securities described in the previous paragraph were not other-than-temporarily impaired for the following reasons:

There is no indication of any significant deterioration of the creditworthiness of the institutions that issued the securities.

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All contractual interest payments on the securities have been received as scheduled, and no information has come to management's attention through the processes previously described which would lead to a conclusion that future contractual payments will not be timely received.

The Corporation does not intend to sell and it is not more likely than not that it will be required to sell the securities in an unrealized loss position before recovery of its amortized cost basis.

Information pertaining to security sales is as follows:

|                                       | Proceeds | Gross Gains | Gross Losses |
|---------------------------------------|----------|-------------|--------------|
| Three months ended September 30, 2013 | \$ 0     | \$ 0        | \$ 0         |
| Nine months ended September 30, 2013  | 33,672   | 822         | (494)        |
| Three months ended September 30, 2012 | 4,090    | 103         | 0            |
| Nine months ended September 30, 2012  | 92,707   | 1,549       | (149)        |

The following is a schedule of the contractual maturity of securities available for sale, excluding equity securities, at September 30, 2013:

|                                       | Amortized<br>Cost | Fair<br>Value     |
|---------------------------------------|-------------------|-------------------|
| 1 year or less                        | \$ 31,904         | \$ 31,651         |
| 1 year - 5 years                      | 137,688           | 138,186           |
| 5 years - 10 years                    | 163,672           | 162,836           |
| After 10 years                        | 42,658            | 41,360            |
|                                       | 375,922           | 374,033           |
| Residential and multi-family mortgage | 258,466           | 255,039           |
| Pooled SBA                            | 71,924            | 69,513            |
| Commercial mortgage                   | 971               | 950               |
| <b>Total debt securities</b>          | <b>\$ 707,283</b> | <b>\$ 699,535</b> |

Mortgage and asset backed securities and pooled SBA securities are not due at a single date; periodic payments are received based on the payment patterns of the underlying collateral.

On September 30, 2013 and December 31, 2012, securities carried at \$340,446 and \$264,813, respectively, were pledged to secure public deposits and for other purposes as provided by law.

**6. LOANS**

Total net loans at September 30, 2013 and December 31, 2012 are summarized as follows:

|                                          | September 30,<br>2013 | December 31,<br>2012 |
|------------------------------------------|-----------------------|----------------------|
| Commercial, industrial, and agricultural | \$ 258,889            | \$ 257,091           |
| Commercial mortgages                     | 305,840               | 261,791              |
| Residential real estate                  | 400,649               | 347,904              |
| Consumer                                 | 62,187                | 58,668               |
| Credit cards                             | 4,800                 | 4,800                |
| Overdrafts                               | 510                   | 971                  |
| Less: unearned discount                  | (3,904)               | (3,401)              |



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|                           |              |            |
|---------------------------|--------------|------------|
| allowance for loan losses | (17,221)     | (14,060)   |
| Loans, net                | \$ 1,011,750 | \$ 913,764 |

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At September 30, 2013 and December 31, 2012, net unamortized loan costs of \$322 and \$232, respectively, have been included in the carrying value of loans.

The Corporation's outstanding loans and related unfunded commitments are primarily concentrated within Central and Western Pennsylvania. The Bank attempts to limit concentrations within specific industries by utilizing dollar limitations to single industries or customers and by entering into participation agreements with third parties. Collateral requirements are established based on management's assessment of the customer.

The Corporation maintains lending policies to control the quality of the loan portfolio. These policies delegate the authority to extend loans under specific guidelines and underwriting standards. These policies are prepared by the Corporation's management and reviewed and ratified annually by the Corporation's Board of Directors.

All relevant documentation, such as the loan application, financial statements and tax returns, required under the lending policies is summarized and provided to management and/or the Corporation's Board of Directors in connection with the loan approval process. Such documentation is subsequently electronically archived in the Corporation's document management system. Pursuant to the Corporation's lending policies, management considers a variety of factors when determining whether to extend credit to a customer, including loan-to-value ratios, FICO scores, quality of the borrower's financial statements, and the ability to obtain personal guarantees.

Commercial, industrial, and agricultural loans comprised 26% and 28% of the Corporation's total loan portfolio at September 30, 2013 and December 31, 2012, respectively. Commercial mortgage loans comprised 30% and 28% of the Corporation's total loan portfolio at September 30, 2013 and December 31, 2012, respectively. Management assigns a risk rating to all commercial loans in excess of \$250,000. The loan-to-value policy guidelines for commercial, industrial, and agricultural loans are generally a maximum of 80% of the value of business equipment, a maximum of 75% of the value of accounts receivable, and a maximum of 60% of the value of business inventory. The loan-to-value policy guideline for commercial mortgage loans is generally a maximum of 85% of the appraised value of the real estate.

Residential real estate loans comprised 40% and 37% of the Corporation's total loan portfolio at September 30, 2013 and December 31, 2012, respectively. The loan-to-value policy guidelines for residential real estate loans vary depending on the collateral position and the specific type of loan. Higher loan-to-value terms may be approved with the appropriate private mortgage insurance coverage. The Corporation also originates and prices loans for sale into the secondary market through Freddie Mac. The rationale for these sales is to mitigate interest rate risk associated with holding lower rate, long-term residential mortgages in the loan portfolio and to generate fee revenue from sales and servicing the loan. The Corporation also offers a variety of unsecured and secured consumer loan and credit card products which represent less than 10% of the total loan portfolio at both September 30, 2013 and December 31, 2012. Terms and collateral requirements vary depending on the size and nature of the loan.

CNB has not underwritten any hybrid loans, payment option loans, or low documentation/no documentation loans. Variable rate loans are generally underwritten at the fully indexed rate. Loan underwriting policies and procedures have not changed materially between any periods presented.

Transactions in the allowance for loan losses for the three months ended September 30, 2013 were as follows:

|                                               | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total     |
|-----------------------------------------------|------------------------------------------------|-------------------------|-------------------------------|----------|-----------------|------------|-----------|
| Allowance for loan losses, July 1, 2013       | \$ 5,338                                       | \$ 5,896                | \$ 2,508                      | \$ 1,555 | \$ 55           | \$ 148     | \$ 15,500 |
| Charge-offs                                   | (169)                                          | (4)                     | (57)                          | (269)    | (19)            | (72)       | (590)     |
| Recoveries                                    | 0                                              | 1,424                   | 1                             | 21       | 3               | 16         | 1,465     |
| Provision (benefit) for loan losses           | 384                                            | (275)                   | 189                           | 454      | 18              | 76         | 846       |
| Allowance for loan losses, September 30, 2013 | \$ 5,553                                       | \$ 7,041                | \$ 2,641                      | \$ 1,761 | \$ 57           | \$ 168     | \$ 17,221 |

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Transactions in the allowance for loan losses for the nine months ended September 30, 2013 were as follows:

|                                               | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total     |
|-----------------------------------------------|------------------------------------------------|-------------------------|-------------------------------|----------|-----------------|------------|-----------|
| Allowance for loan losses, January 1, 2013    | \$ 4,940                                       | \$ 4,697                | \$ 2,466                      | \$ 1,699 | \$ 83           | \$ 175     | \$ 14,060 |
| Charge-offs                                   | (253)                                          | (1,534)                 | (398)                         | (946)    | (48)            | (163)      | (3,342)   |
| Recoveries                                    | 7                                              | 1,427                   | 5                             | 95       | 13              | 65         | 1,612     |
| Provision (benefit) for loan losses           | 859                                            | 2,451                   | 568                           | 913      | 9               | 91         | 4,891     |
| Allowance for loan losses, September 30, 2013 | \$ 5,553                                       | \$ 7,041                | \$ 2,641                      | \$ 1,761 | \$ 57           | \$ 168     | \$ 17,221 |

Transactions in the allowance for loan losses for the three months ended September 30, 2012 were as follows:

|                                               | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total     |
|-----------------------------------------------|------------------------------------------------|-------------------------|-------------------------------|----------|-----------------|------------|-----------|
| Allowance for loan losses, July 1, 2012       | \$ 5,115                                       | \$ 4,553                | \$ 2,225                      | \$ 1,568 | \$ 81           | \$ 148     | \$ 13,690 |
| Charge-offs                                   | (751)                                          | (165)                   | (7)                           | (252)    | (22)            | (80)       | (1,277)   |
| Recoveries                                    | 6                                              | 0                       | 1                             | 18       | 1               | 22         | 48        |
| Provision (benefit) for loan losses           | 103                                            | 504                     | 113                           | 372      | 19              | 77         | 1,188     |
| Allowance for loan losses, September 30, 2012 | \$ 4,473                                       | \$ 4,892                | \$ 2,332                      | \$ 1,706 | \$ 79           | \$ 167     | \$ 13,649 |

Transactions in the allowance for loan losses for the nine months ended September 30, 2012 were as follows:

|                                               | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total     |
|-----------------------------------------------|------------------------------------------------|-------------------------|-------------------------------|----------|-----------------|------------|-----------|
| Allowance for loan losses, January 1, 2012    | \$ 4,511                                       | \$ 4,470                | \$ 1,991                      | \$ 1,404 | \$ 71           | \$ 168     | \$ 12,615 |
| Charge-offs                                   | (1,398)                                        | (401)                   | (231)                         | (890)    | (55)            | (197)      | (3,172)   |
| Recoveries                                    | 14                                             | 0                       | 1                             | 67       | 8               | 78         | 168       |
| Provision for loan losses                     | 1,346                                          | 823                     | 571                           | 1,125    | 55              | 118        | 4,038     |
| Allowance for loan losses, September 30, 2012 | \$ 4,473                                       | \$ 4,892                | \$ 2,332                      | \$ 1,706 | \$ 79           | \$ 167     | \$ 13,649 |

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and is based on the Corporation's impairment method as of September 30, 2013 and December 31, 2012. The recorded investment in loans excludes accrued interest due to its insignificance.

**September 30, 2013**

|                                                 | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total |
|-------------------------------------------------|------------------------------------------------|-------------------------|-------------------------------|----------|-----------------|------------|-------|
| Allowance for loan losses:                      |                                                |                         |                               |          |                 |            |       |
| Ending allowance balance attributable to loans: |                                                |                         |                               |          |                 |            |       |

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|                                                 |                   |                   |                   |                  |                 |               |                     |
|-------------------------------------------------|-------------------|-------------------|-------------------|------------------|-----------------|---------------|---------------------|
| Individually evaluated for impairment           | \$ 573            | \$ 932            | \$ 0              | \$ 0             | \$ 0            | \$ 0          | \$ 1,505            |
| Collectively evaluated for impairment           | 4,980             | 4,209             | 2,641             | 1,761            | 57              | 168           | 13,816              |
| Modified in a troubled debt restructuring       | 0                 | 1,900             | 0                 | 0                | 0               | 0             | 1,900               |
| <b>Total ending allowance balance</b>           | <b>\$ 5,553</b>   | <b>\$ 7,041</b>   | <b>\$ 2,641</b>   | <b>\$ 1,761</b>  | <b>\$ 57</b>    | <b>\$ 168</b> | <b>\$ 17,221</b>    |
| <b>Loans:</b>                                   |                   |                   |                   |                  |                 |               |                     |
| Loans individually evaluated for impairment     | \$ 1,774          | \$ 4,252          | \$ 64             | \$ 0             | \$ 0            | \$ 0          | \$ 6,090            |
| Loans collectively evaluated for impairment     | 255,813           | 289,635           | 400,585           | 58,283           | 4,800           | 510           | 1,009,626           |
| Loans modified in a troubled debt restructuring | 1,302             | 11,953            | 0                 | 0                | 0               | 0             | 13,255              |
| <b>Total ending loans balance</b>               | <b>\$ 258,889</b> | <b>\$ 305,840</b> | <b>\$ 400,649</b> | <b>\$ 58,283</b> | <b>\$ 4,800</b> | <b>\$ 510</b> | <b>\$ 1,028,971</b> |

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**December 31, 2012**

|                                                 | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer         | Credit<br>Cards | Overdrafts    | Total             |
|-------------------------------------------------|------------------------------------------------|-------------------------|-------------------------------|------------------|-----------------|---------------|-------------------|
| <b>Allowance for loan losses:</b>               |                                                |                         |                               |                  |                 |               |                   |
| Ending allowance balance attributable to loans: |                                                |                         |                               |                  |                 |               |                   |
| Individually evaluated for impairment           | \$ 541                                         | \$ 131                  | \$ 81                         | \$ 0             | \$ 0            | \$ 0          | \$ 753            |
| Collectively evaluated for impairment           | 4,399                                          | 3,467                   | 2,385                         | 1,699            | 83              | 175           | 12,208            |
| Modified in a troubled debt restructuring       | 0                                              | 1,099                   | 0                             | 0                | 0               | 0             | 1,099             |
| <b>Total ending allowance balance</b>           | <b>\$ 4,940</b>                                | <b>\$ 4,697</b>         | <b>\$ 2,466</b>               | <b>\$ 1,699</b>  | <b>\$ 83</b>    | <b>\$ 175</b> | <b>\$ 14,060</b>  |
| <b>Loans:</b>                                   |                                                |                         |                               |                  |                 |               |                   |
| Loans individually evaluated for impairment     | \$ 2,623                                       | \$ 10,683               | \$ 593                        | \$ 0             | \$ 0            | \$ 0          | \$ 13,899         |
| Loans collectively evaluated for impairment     | 253,048                                        | 240,907                 | 347,311                       | 55,267           | 4,800           | 971           | 902,304           |
| Loans modified in a troubled debt restructuring | 1,420                                          | 10,201                  | 0                             | 0                | 0               | 0             | 11,621            |
| <b>Total ending loans balance</b>               | <b>\$ 257,091</b>                              | <b>\$ 261,791</b>       | <b>\$ 347,904</b>             | <b>\$ 55,267</b> | <b>\$ 4,800</b> | <b>\$ 971</b> | <b>\$ 927,824</b> |

The following tables present information related to loans individually evaluated for impairment by portfolio segment as of September 30, 2013 and December 31, 2012 and for the three and nine months ended September 30, 2013 and 2012:

**September 30, 2013**

|                                            | Unpaid Principal<br>Balance | Recorded<br>Investment | Allowance for Loan<br>Losses<br>Allocated |
|--------------------------------------------|-----------------------------|------------------------|-------------------------------------------|
| <b>With an allowance recorded:</b>         |                             |                        |                                           |
| Commercial, industrial, and agricultural   | \$ 1,836                    | \$ 1,085               | \$ 573                                    |
| Commercial mortgage                        | 12,017                      | 9,985                  | 2,832                                     |
| Residential real estate                    | 0                           | 0                      | 0                                         |
| <b>With no related allowance recorded:</b> |                             |                        |                                           |
| Commercial, industrial, and agricultural   | 2,604                       | 1,991                  | 0                                         |
| Commercial mortgage                        | 6,246                       | 6,220                  | 0                                         |
| Residential real estate                    | 149                         | 64                     | 0                                         |
| <b>Total</b>                               | <b>\$ 22,852</b>            | <b>\$ 19,345</b>       | <b>\$ 3,405</b>                           |

**December 31, 2012**

|                                            | Unpaid Principal<br>Balance | Recorded<br>Investment | Allowance for Loan<br>Losses<br>Allocated |
|--------------------------------------------|-----------------------------|------------------------|-------------------------------------------|
| <b>With an allowance recorded:</b>         |                             |                        |                                           |
| Commercial, industrial, and agricultural   | \$ 2,542                    | \$ 1,792               | \$ 541                                    |
| Commercial mortgage                        | 5,870                       | 5,329                  | 1,230                                     |
| Residential real estate                    | 416                         | 381                    | 81                                        |
| <b>With no related allowance recorded:</b> |                             |                        |                                           |

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|                                          |                  |                  |                 |
|------------------------------------------|------------------|------------------|-----------------|
| Commercial, industrial, and agricultural | 2,804            | 2,251            | 0               |
| Commercial mortgage                      | 17,285           | 15,555           | 0               |
| Residential real estate                  | 308              | 212              | 0               |
| <b>Total</b>                             | <b>\$ 29,225</b> | <b>\$ 25,520</b> | <b>\$ 1,852</b> |

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|                                            | Three Months Ended<br>September 30, 2013 |                                  |                                         | Nine Months Ended<br>September 30, 2013 |                                  |                                         |
|--------------------------------------------|------------------------------------------|----------------------------------|-----------------------------------------|-----------------------------------------|----------------------------------|-----------------------------------------|
|                                            | Average<br>Recorded<br>Investment        | Interest<br>Income<br>Recognized | Cash<br>Basis<br>Interest<br>Recognized | Average<br>Recorded<br>Investment       | Interest<br>Income<br>Recognized | Cash<br>Basis<br>Interest<br>Recognized |
| <b>With an allowance recorded:</b>         |                                          |                                  |                                         |                                         |                                  |                                         |
| Commercial, industrial, and agricultural   | \$ 1,267                                 | \$ 3                             | \$ 3                                    | \$ 1,439                                | \$ 4                             | \$ 4                                    |
| Commercial mortgage                        | 8,337                                    | 0                                | 0                                       | 7,657                                   | 3                                | 3                                       |
| Residential real estate                    | 0                                        | 1                                | 1                                       | 191                                     | 4                                | 4                                       |
| <b>With no related allowance recorded:</b> |                                          |                                  |                                         |                                         |                                  |                                         |
| Commercial, industrial, and agricultural   | 2,055                                    | 0                                | 0                                       | 2,121                                   | 0                                | 0                                       |
| Commercial mortgage                        | 10,602                                   | 0                                | 0                                       | 10,888                                  | 0                                | 0                                       |
| Residential real estate                    | 69                                       | 0                                | 0                                       | 138                                     | 0                                | 0                                       |
| <b>Total</b>                               | <b>\$ 22,330</b>                         | <b>\$ 4</b>                      | <b>\$ 4</b>                             | <b>\$ 22,434</b>                        | <b>\$ 11</b>                     | <b>\$ 11</b>                            |

|                                            | Three Months Ended<br>September 30, 2012 |                                  |                                         | Nine Months Ended<br>September 30, 2012 |                                  |                                         |
|--------------------------------------------|------------------------------------------|----------------------------------|-----------------------------------------|-----------------------------------------|----------------------------------|-----------------------------------------|
|                                            | Average<br>Recorded<br>Investment        | Interest<br>Income<br>Recognized | Cash<br>Basis<br>Interest<br>Recognized | Average<br>Recorded<br>Investment       | Interest<br>Income<br>Recognized | Cash<br>Basis<br>Interest<br>Recognized |
| <b>With an allowance recorded:</b>         |                                          |                                  |                                         |                                         |                                  |                                         |
| Commercial, industrial, and agricultural   | \$ 4,140                                 | \$ 0                             | \$ 0                                    | \$ 3,406                                | \$ 3                             | \$ 3                                    |
| Commercial mortgage                        | 6,180                                    | 3                                | 3                                       | 5,549                                   | 3                                | 3                                       |
| Residential real estate                    | 476                                      | 3                                | 3                                       | 322                                     | 11                               | 11                                      |
| <b>With no related allowance recorded:</b> |                                          |                                  |                                         |                                         |                                  |                                         |
| Commercial, industrial, and agricultural   | 3,506                                    | 0                                | 0                                       | 3,459                                   | 0                                | 0                                       |
| Commercial mortgage                        | 11,971                                   | 0                                | 0                                       | 12,016                                  | 0                                | 0                                       |
| Residential real estate                    | 151                                      | 0                                | 0                                       | 75                                      | 0                                | 0                                       |
| <b>Total</b>                               | <b>\$ 26,424</b>                         | <b>\$ 6</b>                      | <b>\$ 6</b>                             | <b>\$ 24,827</b>                        | <b>\$ 17</b>                     | <b>\$ 17</b>                            |

The following table presents the recorded investment in nonaccrual loans and loans past due over 90 days still accruing interest by class of loans as of September 30, 2013 and December 31, 2012:

|                                          | September 30, 2013 |                                              | December 31, 2012 |                                              |
|------------------------------------------|--------------------|----------------------------------------------|-------------------|----------------------------------------------|
|                                          | Nonaccrual         | Past Due<br>Over 90 Days<br>Still on Accrual | Nonaccrual        | Past Due<br>Over 90 Days<br>Still on Accrual |
|                                          |                    |                                              |                   |                                              |
| Commercial, industrial, and agricultural | \$ 2,566           | \$ 0                                         | \$ 3,073          | \$ 0                                         |
| Commercial mortgages                     | 8,946              | 0                                            | 8,570             | 109                                          |
| Residential real estate                  | 1,993              | 58                                           | 2,792             | 18                                           |
| Consumer                                 | 683                | 11                                           | 10                | 217                                          |
| Credit cards                             | 0                  | 54                                           | 0                 | 13                                           |
| <b>Total</b>                             | <b>\$ 14,188</b>   | <b>\$ 123</b>                                | <b>\$ 14,445</b>  | <b>\$ 357</b>                                |

Nonaccrual loans and loans past due over 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

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Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt.



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The following table presents the aging of the recorded investment in past due loans as of September 30, 2013 and December 31, 2012 by class of loans.

**September 30, 2013**

|                                          | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | Greater Than<br>90 Days<br>Past Due | Total Past<br>Due | Loans Not<br>Past Due | Total               |
|------------------------------------------|------------------------|------------------------|-------------------------------------|-------------------|-----------------------|---------------------|
| Commercial, industrial, and agricultural | \$ 126                 | \$ 523                 | \$ 2,478                            | \$ 3,127          | \$ 255,762            | \$ 258,889          |
| Commercial mortgages                     | 1,173                  | 0                      | 5,784                               | 6,957             | 298,883               | 305,840             |
| Residential real estate                  | 860                    | 949                    | 1,954                               | 3,763             | 396,886               | 400,649             |
| Consumer                                 | 569                    | 266                    | 694                                 | 1,529             | 56,754                | 58,283              |
| Credit cards                             | 24                     | 23                     | 54                                  | 101               | 4,699                 | 4,800               |
| Overdrafts                               | 0                      | 0                      | 0                                   | 0                 | 510                   | 510                 |
| <b>Total</b>                             | <b>\$ 2,752</b>        | <b>\$ 1,761</b>        | <b>\$ 10,964</b>                    | <b>\$ 15,477</b>  | <b>\$ 1,013,494</b>   | <b>\$ 1,028,971</b> |

**December 31, 2012**

|                                          | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | Greater Than<br>90 Days<br>Past Due | Total Past<br>Due | Loans Not<br>Past Due | Total             |
|------------------------------------------|------------------------|------------------------|-------------------------------------|-------------------|-----------------------|-------------------|
| Commercial, industrial, and agricultural | \$ 724                 | \$ 157                 | \$ 2,968                            | \$ 3,849          | \$ 253,242            | \$ 257,091        |
| Commercial mortgages                     | 1,162                  | 3,197                  | 8,679                               | 13,038            | 248,753               | 261,791           |
| Residential real estate                  | 1,390                  | 641                    | 2,700                               | 4,731             | 343,173               | 347,904           |
| Consumer                                 | 724                    | 203                    | 227                                 | 1,154             | 54,113                | 55,267            |
| Credit cards                             | 39                     | 9                      | 13                                  | 61                | 4,739                 | 4,800             |
| Overdrafts                               | 0                      | 0                      | 0                                   | 0                 | 971                   | 971               |
| <b>Total</b>                             | <b>\$ 4,039</b>        | <b>\$ 4,207</b>        | <b>\$ 14,587</b>                    | <b>\$ 22,833</b>  | <b>\$ 904,991</b>     | <b>\$ 927,824</b> |

**Troubled Debt Restructurings**

The terms of certain loans have been modified as troubled debt restructurings. The modification of the terms of such loans included either or both of the following: a reduction of the stated interest rate of the loan or an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk.

The following table presents the number of loans, loan balances, and specific reserves for loans that have been restructured in a troubled debt restructuring as of September 30, 2013 and December 31, 2012.

|                                          | September 30, 2013 |                 |                     | December 31, 2012  |                 |                     |
|------------------------------------------|--------------------|-----------------|---------------------|--------------------|-----------------|---------------------|
|                                          | Number of<br>Loans | Loan<br>Balance | Specific<br>Reserve | Number of<br>Loans | Loan<br>Balance | Specific<br>Reserve |
| Commercial, industrial, and agricultural | 2                  | \$ 1,302        | \$ 0                | 2                  | \$ 1,420        | \$ 0                |
| Commercial mortgages                     | 10                 | 11,953          | 1,900               | 8                  | 10,201          | 1,099               |
| Residential real estate                  | 0                  | 0               | 0                   | 0                  | 0               | 0                   |
| Consumer                                 | 0                  | 0               | 0                   | 0                  | 0               | 0                   |
| Credit cards                             | 0                  | 0               | 0                   | 0                  | 0               | 0                   |

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|       |    |           |          |    |           |          |
|-------|----|-----------|----------|----|-----------|----------|
| Total | 12 | \$ 13,255 | \$ 1,900 | 10 | \$ 11,621 | \$ 1,099 |
|-------|----|-----------|----------|----|-----------|----------|

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The following tables present loans by class modified as troubled debt restructurings that occurred during the nine months ended September 30, 2013 and 2012. There was one loan modified as a troubled debt restructuring during the three months ended September 30, 2013, and no loans modified as troubled debt restructurings during the three months ended September 30, 2012.

|                                          | Nine Months Ended September 30, 2013 |                                                        |                                                            |
|------------------------------------------|--------------------------------------|--------------------------------------------------------|------------------------------------------------------------|
|                                          | Number of<br>Loans                   | Pre-Modification<br>Outstanding Recorded<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment |
| Commercial, industrial, and agricultural | 0                                    | \$ 0                                                   | \$ 0                                                       |
| Commercial mortgages                     | 2                                    | 3,615                                                  | 3,549                                                      |
| Residential real estate                  | 0                                    | 0                                                      | 0                                                          |
| Consumer                                 | 0                                    | 0                                                      | 0                                                          |
| Credit cards                             | 0                                    | 0                                                      | 0                                                          |
| <b>Total</b>                             | <b>2</b>                             | <b>\$ 3,615</b>                                        | <b>\$ 3,549</b>                                            |

|                                          | Nine Months Ended September 30, 2012 |                                                        |                                                            |
|------------------------------------------|--------------------------------------|--------------------------------------------------------|------------------------------------------------------------|
|                                          | Number of<br>Loans                   | Pre-Modification<br>Outstanding Recorded<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment |
| Commercial, industrial, and agricultural | 1                                    | \$ 310                                                 | \$ 310                                                     |
| Commercial mortgages                     | 4                                    | 2,556                                                  | 2,556                                                      |
| Residential real estate                  | 0                                    | 0                                                      | 0                                                          |
| Consumer                                 | 0                                    | 0                                                      | 0                                                          |
| Credit cards                             | 0                                    | 0                                                      | 0                                                          |
| <b>Total</b>                             | <b>5</b>                             | <b>\$ 2,866</b>                                        | <b>\$ 2,866</b>                                            |

The troubled debt restructurings described above increased the allowance for loan losses by \$562 and \$0 during the three months ended September 30, 2013 and 2012 and \$562 and \$0 during the nine months ended September 30, 2013 and 2012.

Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from 4 to 15 years. Modifications involving an extension of the maturity date were for periods ranging from 4 to 18 years.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms. Except as discussed below, all loans modified in troubled debt restructurings are performing in accordance with their modified terms as of September 30, 2013 and December 31, 2012 and no principal balances were forgiven in connection with the loan restructurings. In the first quarter of 2013, the Corporation recorded a partial chargeoff of \$595 for a commercial mortgage loan with a balance of \$1,660 that had defaulted under its restructured terms in 2012 and was placed on nonaccrual status. The Corporation recorded an additional provision for loan losses of \$127 and \$262 on this loan during the three and nine months ended September 30, 2013, and \$503 during both the three and nine months ended September 30, 2012. In the second quarter of 2013, a commercial mortgage loan with a balance of \$1,086 defaulted under its restructured terms and was placed on nonaccrual status. The Corporation recorded an additional provision for loan losses of \$0 and \$588 during the three and nine months ended September 30, 2013. In the third quarter of 2013, an impaired commercial mortgage loan that was placed on non-accrual status in the second quarter of 2013 and having a balance of \$3,269 was modified in a troubled debt restructuring. The Corporation recorded an additional provision for loan losses of \$562 for this loan during the three months ended September 30, 2013.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without a loan modification. This evaluation is performed using the Corporation's internal underwriting policies. The Corporation has no further loan commitments to customers whose loans are classified as a troubled debt restructuring.



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Generally, non-performing troubled debt restructurings are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

**Credit Quality Indicators**

The Corporation classifies commercial, industrial, and agricultural loans and commercial mortgage loans into risk categories based on relevant information about the ability of borrowers to service their debt, such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. Loans with outstanding balances greater than \$1 million are analyzed at least semiannually and loans with outstanding balances of less than \$1 million are analyzed at least annually.

The Corporation uses the following definitions for risk ratings:

**Special Mention:** Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Corporation's credit position at some future date.

**Substandard:** Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected.

**Doubtful:** Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not rated as special mention, substandard, or doubtful are considered to be pass rated loans. All loans included in the following tables have been assigned a risk rating within 12 months of the balance sheet date.

**September 30, 2013**

|                                          | Pass              | Special<br>Mention | Substandard      | Doubtful        | Total             |
|------------------------------------------|-------------------|--------------------|------------------|-----------------|-------------------|
| Commercial, industrial, and agricultural | \$ 230,412        | \$ 6,997           | \$ 21,349        | \$ 131          | \$ 258,889        |
| Commercial mortgages                     | 263,115           | 9,956              | 30,040           | 2,729           | 305,840           |
| <b>Total</b>                             | <b>\$ 493,527</b> | <b>\$ 16,953</b>   | <b>\$ 51,389</b> | <b>\$ 2,860</b> | <b>\$ 564,729</b> |

**December 31, 2012**

|                                          | Pass              | Special<br>Mention | Substandard      | Doubtful      | Total             |
|------------------------------------------|-------------------|--------------------|------------------|---------------|-------------------|
| Commercial, industrial, and agricultural | \$ 234,835        | \$ 6,641           | \$ 15,459        | \$ 156        | \$ 257,091        |
| Commercial mortgages                     | 225,294           | 12,294             | 23,501           | 702           | 261,791           |
| <b>Total</b>                             | <b>\$ 460,129</b> | <b>\$ 18,935</b>   | <b>\$ 38,960</b> | <b>\$ 858</b> | <b>\$ 518,882</b> |

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The Corporation considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential real estate, consumer, and credit card loan classes, the Corporation also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in residential, consumer, and credit card loans based on payment activity as of September 30, 2013 and December 31, 2012:

|                | September 30, 2013         |                  |                 | December 31, 2012          |                  |                 |
|----------------|----------------------------|------------------|-----------------|----------------------------|------------------|-----------------|
|                | Residential<br>Real Estate | Consumer         | Credit<br>Cards | Residential<br>Real Estate | Consumer         | Credit<br>Cards |
| Performing     | \$ 398,598                 | \$ 57,589        | \$ 4,746        | \$ 345,094                 | \$ 55,040        | \$ 4,787        |
| Non-performing | 2,051                      | 694              | 54              | 2,810                      | 227              | 13              |
| <b>Total</b>   | <b>\$ 400,649</b>          | <b>\$ 58,283</b> | <b>\$ 4,800</b> | <b>\$ 347,904</b>          | <b>\$ 55,267</b> | <b>\$ 4,800</b> |

The Corporation considers all overdraft loans to be performing loans given their short-term duration.

The Corporation's portfolio of residential real estate and consumer loans maintained within Holiday Financial Services Corporation ( Holiday ), a subsidiary that offers small balance unsecured and secured loans, primarily collateralized by automobiles and equipment, to borrowers with higher risk characteristics than are typical in the Bank's consumer loan portfolio, are considered to be subprime loans.

Holiday's loan portfolio is summarized as follows at September 30, 2013 and December 31, 2012:

|                         | September 30,<br>2013 | December 31,<br>2012 |
|-------------------------|-----------------------|----------------------|
| Consumer                | \$ 23,909             | \$ 21,535            |
| Residential real estate | 1,397                 | 954                  |
| Less: unearned discount | (3,904)               | (3,401)              |
| <b>Total</b>            | <b>\$ 21,402</b>      | <b>\$ 19,088</b>     |

**7. DEPOSITS**

Total deposits at September 30, 2013 and December 31, 2012 are summarized as follows (in thousands):

|                                | Percentage<br>Change | September 30, 2013 | December 31, 2012 |
|--------------------------------|----------------------|--------------------|-------------------|
| Checking, non-interest bearing | 8.1%                 | \$ 189,362         | \$ 175,239        |
| Checking, interest bearing     | 11.3%                | 374,826            | 336,911           |
| Savings accounts               | 5.5%                 | 801,677            | 759,910           |
| Certificates of deposit        | (12.5%)              | 186,416            | 212,943           |
|                                | 4.5%                 | \$ 1,552,281       | \$ 1,485,003      |

**8. EARNINGS PER SHARE**

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the applicable period, excluding outstanding participating securities. Diluted earnings per share is computed using the weighted average number of shares determined for the basic computation plus the dilutive effect of potential common shares issuable under certain stock compensation plans. For

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the three and nine months ended September 30, 2013, 36,203 shares issuable pursuant to outstanding stock options were excluded from the diluted earnings per share calculations because the strike prices associated with the options exceeded the market price of the Corporation's common stock thus making the

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shares anti-dilutive. For the three and nine months ended September 30, 2012, 37,500 shares issuable pursuant to outstanding stock options were excluded from the diluted earnings per share calculations because the strike prices associated with the options exceeded the market price of the Corporation's common stock thus making the shares anti-dilutive.

Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are included in the computation of earnings per share pursuant to the two-class method. The Corporation has determined that its outstanding non-vested stock awards are participating securities.

The computation of basic and diluted earnings per share is shown below (in thousands except per share data):

|                                                                                                  | Three months ended<br>September 30, |          | Nine months ended<br>September 30, |           |
|--------------------------------------------------------------------------------------------------|-------------------------------------|----------|------------------------------------|-----------|
|                                                                                                  | 2013                                | 2012     | 2013                               | 2012      |
| Net income per consolidated statements of income                                                 | \$ 4,703                            | \$ 4,563 | \$ 11,951                          | \$ 13,246 |
| Net earnings allocated to participating securities                                               | (21)                                | (17)     | (56)                               | (50)      |
| Net earnings allocated to common stock                                                           | \$ 4,682                            | \$ 4,546 | \$ 11,895                          | \$ 13,196 |
| <b>Basic earnings per common share computation:</b>                                              |                                     |          |                                    |           |
| Distributed earnings allocated to common stock                                                   | \$ 2,054                            | \$ 2,045 | \$ 6,161                           | \$ 6,130  |
| Undistributed earnings allocated to common stock                                                 | 2,628                               | 2,501    | 5,734                              | 7,066     |
| Net earnings allocated to common stock                                                           | \$ 4,682                            | \$ 4,546 | \$ 11,895                          | \$ 13,196 |
| Weighted average common shares outstanding, including shares considered participating securities | 12,513                              | 12,448   | 12,505                             | 12,430    |
| Less: Average participating securities                                                           | (51)                                | (41)     | (52)                               | (42)      |
| Weighted average shares                                                                          | 12,462                              | 12,407   | 12,453                             | 12,388    |
| Basic earnings per common share                                                                  | \$ 0.38                             | \$ 0.37  | \$ 0.96                            | \$ 1.07   |
| <b>Diluted earnings per common share computation:</b>                                            |                                     |          |                                    |           |
| Net earnings allocated to common stock                                                           | \$ 4,682                            | \$ 4,546 | \$ 11,895                          | \$ 13,196 |
| Weighted average common shares outstanding for basic earnings per common share                   | 12,462                              | 12,407   | 12,453                             | 12,388    |
| Add: Dilutive effects of assumed exercises of stock options                                      | 2                                   | 4        | 1                                  | 4         |
| Weighted average shares and dilutive potential common shares                                     | 12,464                              | 12,411   | 12,454                             | 12,392    |
| Diluted earnings per common share                                                                | \$ 0.38                             | \$ 0.37  | \$ 0.96                            | \$ 1.06   |

**9. DERIVATIVE INSTRUMENTS**

The Corporation records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and the resulting designation. Derivatives used to hedge the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives used to hedge the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges.



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For derivatives designated as cash flow hedges, the effective portion of the changes in the fair value of the derivative is initially reported in other comprehensive income (outside of earnings) and subsequently reclassified into earnings when the hedged transaction affects earnings, and the ineffective portion of changes in the fair value of the derivative is recognized directly in earnings. The Corporation assesses the effectiveness of each hedging relationship by comparing the changes in cash flows of the derivative hedging instrument with the changes in cash flows of the designated hedged item or transaction.

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On May 3, 2011, the Corporation executed an interest rate swap agreement with a 5 year term and an effective date of September 15, 2013 in order to hedge cash flows associated with \$10 million of a subordinated note that was issued by the Corporation during 2007 and elected cash flow hedge accounting for the agreement. The Corporation's objective in using this derivative is to add stability to interest expense and to manage its exposure to interest rate risk. The interest rate swap involves the receipt of variable-rate amounts in exchange for fixed-rate payments from September 15, 2013 to September 15, 2018 without exchange of the underlying notional amount. At September 30, 2013, the variable rate on the subordinated debt was 1.80% (LIBOR plus 155 basis points) and the Corporation was paying 5.57% (4.02% fixed rate plus 155 basis points).

On August 1, 2008, the Corporation executed an interest rate swap agreement with a 5 year term and an effective date of September 15, 2008 in order to hedge cash flows associated with \$10 million of a subordinated note discussed above. The Corporation's objective in using this derivative was to add stability to interest expense and to manage its exposure to interest rate risk. The interest rate swap involved the receipt of variable-rate amounts in exchange for fixed-rate payments from September 15, 2008 to the September 15, 2013 maturity date without exchange of the underlying notional amount.

As of September 30, 2013, no derivatives were designated as fair value hedges or hedges of net investments in foreign operations. Additionally, the Corporation does not use derivatives for trading or speculative purposes and currently does not have any derivatives that are not designated as hedges.

The following tables provide information about the amounts and locations of activity related to the interest rate swaps designated as cash flow hedges within the Corporation's consolidated balance sheet and statement of income as of September 30, 2013 and December 31, 2012 and for the three and nine months ended September 30, 2013 and 2012:

|                                 | Balance Sheet<br>Location                   | Fair value as of      |                      |         |
|---------------------------------|---------------------------------------------|-----------------------|----------------------|---------|
|                                 |                                             | September 30,<br>2013 | December 31,<br>2012 |         |
| Interest rate contracts         | Accrued interest and<br>other liabilities   | (\$1,241)             | (\$ 1,745)           |         |
| <b>For the Three Months</b>     |                                             |                       |                      |         |
| <b>Ended September 30, 2013</b> | (a)                                         | (b)                   | (c)                  | (d) (e) |
| Interest rate contracts         | Interest expense<br>subordinated debentures | (\$102)               | Other<br>income      | \$ 0    |
| <b>For the Nine Months</b>      |                                             |                       |                      |         |
| <b>Ended September 30, 2013</b> | (a)                                         | (b)                   | (c)                  | (d) (e) |
| Interest rate contracts         | Interest expense<br>subordinated debentures | (\$304)               | Other<br>income      | \$ 0    |
| <b>For the Three Months</b>     |                                             |                       |                      |         |
| <b>Ended September 30, 2012</b> | (a)                                         | (b)                   | (c)                  | (d) (e) |
| Interest rate contracts         | Interest expense<br>subordinated debentures | (\$98)                | Other<br>income      | \$ 0    |
| <b>For the Nine Months</b>      |                                             |                       |                      |         |
| <b>Ended September 30, 2012</b> | (a)                                         | (b)                   | (c)                  | (d) (e) |
| Interest rate contracts         | Interest expense<br>subordinated debentures | (\$290)               | Other<br>income      | \$ 0    |

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- (a) Amount of Gain or (Loss) Recognized in Other Comprehensive Loss on Derivative (Effective Portion), net of tax
- (b) Location of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)
- (c) Amount of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)
- (d) Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
- (e) Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)

Amounts reported in accumulated other comprehensive loss related to the interest rate swap will be reclassified to interest expense as interest payments are made on the subordinated debentures. Such amounts reclassified from accumulated other comprehensive loss to interest expense in the next twelve months are expected to be \$377. As of September 30, 2013 and December 31, 2012, a cash collateral balance in the amount of \$1,350 and \$1,950, respectively, was maintained with a counterparty to the interest rate swaps. These balances are included in interest bearing deposits with other banks on the consolidated balance sheet.

**10. RECENT ACCOUNTING PRONOUNCEMENTS**

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (ASU 2013-02). ASU 2013-02 requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about these amounts. ASU 2013-02 is effective prospectively for reporting periods beginning after December 15, 2012. The effect of adopting ASU 2013-02 did not have a material effect on the Corporation's financial statements.

In February 2013, the FASB issued Accounting Standards Update 2013-04, Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date (ASU 2013-04). ASU 2013-04 provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of the guidance is fixed at the reporting date, except for obligations addressed within existing guidance in U.S. GAAP. ASU 2013-04 is effective for reporting periods beginning after December 15, 2013. The Corporation is evaluating the effect that the adoption of ASU 2013-04 will have on its financial statements.

In July 2013, the FASB issued Accounting Standards Update 2013-10, Derivatives and Hedging (Topic 815), Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes (ASU 2013-10). ASU 2013-10 was issued to permit the Fed Funds Effective Swap Rate to be used as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to direct Treasury obligations of the U.S. Government and the London Interbank Offered Rate (LIBOR) swap rate. ASU 2013-10 is effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The adoption of ASU 2013-10 did not have a material effect on the Corporation's financial statements.

In July 2013, the FASB issued Accounting Standards Update 2013-11, Income Taxes (Topic 740), Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (ASU 2013-11). ASU 2013-11 was issued to clarify the financial presentation of unrecognized tax benefits in the instances described. ASU 2013-11 is effective for reporting periods beginning after December 15, 2013. The effect of adopting ASU 2013-11 is not expected to have a material effect on the Corporation's financial statements.

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**ITEM 2**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
AND RESULTS OF OPERATIONS**

The following discussion and analysis of the consolidated financial statements of CNB Financial Corporation (the Corporation) is presented to provide insight into management's assessment of financial results. The Corporation's subsidiary, CNB Bank (the Bank), provides financial services to individuals and businesses primarily within its primary market area of the Pennsylvania counties of Cambria, Cameron, Centre, Clearfield, Crawford, Elk, Indiana, Jefferson, McKean and Warren. As ERIEBANK, a division of CNB Bank, the Bank operates in the Pennsylvania counties of Crawford, Erie, and Warren. As FC Bank, a division of CNB Bank, the Bank operates in the Ohio counties of Crawford, Richland, Ashland, Wayne, Marion, Morrow, Knox, Holmes, Delaware, and Franklin.

The Bank is subject to regulation, supervision and examination by the Pennsylvania State Department of Banking as well as the Federal Deposit Insurance Corporation. The financial condition and results of operations of the Corporation and its consolidated subsidiaries are not necessarily indicative of future performance. CNB Securities Corporation is incorporated in Delaware and currently maintains investments in debt and equity securities. County Reinsurance Company is an Arizona corporation and provides credit life and disability insurance for customers of CNB Bank. CNB Insurance Agency, incorporated in Pennsylvania, provides for the sale of nonproprietary annuities and other insurance products. Holiday Financial Services Corporation (Holiday), incorporated in Pennsylvania, offers small balance unsecured loans and secured loans, primarily collateralized by automobiles and equipment, to borrowers with higher risk characteristics.

When we use the terms we, us and our, we mean CNB Financial Corporation and its subsidiaries. Management's discussion and analysis should be read in conjunction with the Corporation's consolidated financial statements and related notes.

**COMPLETED ACQUISITION**

On March 26, 2013, the Corporation announced the signing of a definitive merger agreement to acquire FC Banc Corp. and its subsidiary, The Farmers Citizens Bank, for \$30.00 per share in cash and stock, or approximately \$40.4 million in the aggregate. The transaction closed on October 11, 2013. Farmers Citizens Bank served the northern Ohio markets of Bucyrus, Cardington, Fredericktown, Mount Hope and Shiloh, as well as the markets of Worthington and Upper Arlington in the greater Columbus, Ohio area, with 8 branch locations. The Corporation will continue to operate these 8 branch locations as FCBank, a division of CNB Bank, with local decision making and oversight.

In order to facilitate its entry into the central Ohio market, the Corporation opened a loan production office in Dublin, Ohio in the third quarter of 2013. Management plans to incorporate this office into the commercial banking division of FCBank.

**GENERAL OVERVIEW**

Management concentrates on return on average equity, earnings per share, asset quality, and other metrics to measure the performance of the Corporation. The interest rate environment will continue to play an important role in the future earnings of the Corporation. Some compression of the net interest margin was experienced in 2012 and the net interest margin has decreased 11 basis points in the first nine months of 2013 compared to the first nine months of 2012 as a result of the current interest rate environment. During the past several years, in order to address the historic lows on various key interest rates such as the Prime Rate and 3-month LIBOR, the Corporation has taken a variety of measures including instituting rate floors on our commercial lines of credit and home equity lines. In addition, the Corporation decreased interest rates on certain deposit products during 2012 and the first nine months of 2013 but maintained deposit growth as a result of successful marketing and business development strategies. Non-interest costs are expected to increase with the growth of the Corporation; however, management's growth strategies are expected to also result in an increase in earning assets as well as enhanced non-interest income which is expected to more than offset increases in non-interest expenses during the remainder of 2013 and beyond. While past results are not an indication of future earnings, management believes the Corporation is well-positioned to sustain core earnings during 2013.

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The Dodd-Frank Act, enacted into law on July 21, 2010, includes numerous provisions designed to strengthen the financial industry, enhance consumer protection, expand disclosures and provide for transparency, and significantly changed the bank regulatory structure and affected and will continue to affect the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act also created a Consumer Financial Protection Bureau (CFPB), which is authorized to write rules on a number of consumer financial products, and a Financial Services Oversight Council, which is empowered to determine which entities are systematically significant and require tougher regulations.

The Dodd-Frank Act requires various federal agencies to adopt a broad range of new rules and regulations and to prepare various studies and reports for Congress.

It is difficult to predict at this time what specific impact certain provisions of the Dodd-Frank Act and the implementing rules and regulations, many which have yet to be written, will have on the Corporation, including any regulations promulgated by the CFPB. The legislation and any implementing rules that are ultimately issued could have adverse implications on the financial industry, the competitive environment, and the Corporation's ability to conduct business. The Corporation will have to apply resources to ensure that it is in compliance with all applicable provisions of the Dodd-Frank Act and any implementing rules, which may increase its costs of operations and adversely impact its earnings.

## **CASH AND CASH EQUIVALENTS**

Cash and cash equivalents totaled \$32.9 million at September 30, 2013 compared to \$31.9 million at December 31, 2012. Cash and cash equivalents fluctuate based on the timing and amount of liquidity events that occur in the normal course of business.

Management believes the liquidity needs of the Corporation are satisfied by the current balance of cash and cash equivalents, readily available access to traditional funding sources, and the portion of the investment and loan portfolios that mature within one year. These sources of funds will enable the Corporation to meet cash obligations and off-balance sheet commitments as they come due.

## **SECURITIES**

Securities available for sale and trading securities have combined to decrease \$36.9 million or 5.0% since December 31, 2012, as the Corporation has been able to deploy cash flows from the securities portfolio in its loan portfolio. See the notes to the consolidated financial statements for additional detail concerning the composition of the Corporation's securities portfolio and the process for evaluating securities for other-than-temporary impairment.

The Corporation generally buys into the market over time and does not attempt to time its transactions. In doing this, the highs and lows of the market are averaged into the portfolio and minimize the overall effect of different rate environments. Management monitors the earnings performance and the effectiveness of the liquidity of the securities portfolio on a regular basis through meetings of the Asset/Liability Committee of the Corporation's Board of Directors (ALCO). The ALCO also reviews and manages interest rate risk for the Corporation. Through active balance sheet management and analysis of the securities portfolio, a sufficient level of liquidity is maintained to satisfy depositor requirements and various credit needs of our customers.

## **LOANS**

The Corporation experienced an increase in loans, net of unearned discount, of \$101.1 million, or 10.9%, during the first nine months of 2013. Lending efforts consist principally of commercial and retail lending, which includes single family residential mortgages and other consumer loans. The Corporation views commercial lending as its competitive advantage and continues to focus on this area by hiring and retaining experienced loan officers and supporting them with quality credit analysis. The Corporation expects sustained loan demand throughout the remainder of 2013.

**Table of Contents****ALLOWANCE FOR LOAN LOSSES**

The allowance for loan losses is established by provisions for losses in the loan portfolio as well as overdrafts in deposit accounts. These provisions are charged against current income. Loans and overdrafts deemed not collectible are charged off against the allowance while any subsequent collections are recorded as recoveries and increase the allowance.

The table below shows activity within the allowance account for the specified periods (in thousands):

|                                                  | Nine months ending<br>September 30,<br>2013 | Year ending<br>December 31, 2012 | Nine months ending<br>September<br>30, 2012 |
|--------------------------------------------------|---------------------------------------------|----------------------------------|---------------------------------------------|
| Balance at beginning of period                   | \$ 14,060                                   | \$ 12,615                        | \$ 12,615                                   |
| Charge-offs:                                     |                                             |                                  |                                             |
| Commercial, industrial, and agricultural         | 253                                         | 2,871                            | 1,398                                       |
| Commercial mortgages                             | 1,534                                       | 401                              | 401                                         |
| Residential real estate                          | 398                                         | 304                              | 231                                         |
| Consumer                                         | 946                                         | 1,279                            | 890                                         |
| Credit cards                                     | 48                                          | 78                               | 55                                          |
| Overdrafts                                       | 163                                         | 257                              | 197                                         |
|                                                  | 3,342                                       | 5,190                            | 3,172                                       |
| Recoveries:                                      |                                             |                                  |                                             |
| Commercial, industrial, and agricultural         | 7                                           | 45                               | 14                                          |
| Commercial mortgages                             | 1,427                                       |                                  |                                             |
| Residential real estate                          | 5                                           | 1                                | 1                                           |
| Consumer                                         | 95                                          | 91                               | 67                                          |
| Credit cards                                     | 13                                          | 18                               | 8                                           |
| Overdraft deposit accounts                       | 65                                          | 99                               | 78                                          |
|                                                  | 1,612                                       | 254                              | 168                                         |
| Net charge-offs                                  | (1,730)                                     | (4,936)                          | (3,004)                                     |
| Provision for loan losses                        | 4,891                                       | 6,381                            | 4,038                                       |
| Balance at end of period                         | \$ 17,221                                   | \$ 14,060                        | \$ 13,649                                   |
| Loans, net of unearned                           | \$ 1,028,971                                | \$ 927,824                       | \$ 910,217                                  |
| Allowance to net loans                           | 1.67%                                       | 1.52%                            | 1.50%                                       |
| Net charge-offs to average loans<br>(annualized) | 0.24%                                       | 0.55%                            | 0.45%                                       |
| Nonperforming assets                             | \$ 14,487                                   | \$ 15,127                        | \$ 19,502                                   |
| Nonperforming % of total assets                  | 0.79%                                       | 0.85%                            | 1.12%                                       |

The adequacy of the allowance for loan losses is subject to a formal analysis by the credit administrator of the Corporation. As part of the formal analysis, delinquencies and losses are monitored monthly. The loan portfolio is divided into several categories in order to better analyze the entire pool. First is a selection of classified loans that is given a specific reserve. The remaining loans are pooled, by category, into these segments:

Reviewed

Commercial, industrial, and agricultural

Homogeneous Commercial mortgages

Residential real estate

Consumer

Credit cards

Overdrafts

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The reviewed loan pools are further segregated into four categories: special mention, substandard, doubtful, and unclassified. Historical loss factors are calculated for each pool excluding overdrafts based on the previous eight quarters of experience. The homogeneous pools are evaluated by analyzing the historical loss factors from the most previous quarter end and the two most recent year ends.

The historical loss factors for both the reviewed and homogeneous pools are adjusted based on these six qualitative factors:

levels of and trends in delinquencies, non-accrual loans, and classified loans;

trends in volume and terms of loans;

effects of any changes in lending policies and procedures;

experience, ability and depth of management;

national and local economic trends and conditions; and

concentrations of credit.

The methodology described above was created using the experience of the Corporation's credit administrator, guidance from the regulatory agencies, expertise of a third-party loan review provider, and discussions with peers. The resulting factors are applied to the pool balances in order to estimate the probable risk of loss within each pool. Prudent business practices dictate that the level of the allowance, as well as corresponding charges to the provision for loan losses, should be commensurate with identified areas of risk within the loan portfolio and the attendant risks inherent therein. The quality of the credit risk management function and the overall administration of this vital segment of the Corporation's assets are critical to the ongoing success of the Corporation.

The previously mentioned analysis considers numerous historical and other factors to analyze the adequacy of the allowance and current period charges against the provision for loan losses. Management uses the analysis to compare and plot the actual level of the allowance against the aggregate amount of loans adversely classified in order to compute the estimated probable losses associated with those loans. Management then determines the current adequacy of the allowance and evaluates trends that may be developing. The volume and composition of the Corporation's loan portfolio continue to reflect growth in commercial credits including commercial real estate loans.

As mentioned in the Loans section of this analysis, management considers commercial lending to be a competitive advantage and continues to focus on this area as part of its strategic growth initiatives. However, management recognizes and considers the fact that risk is more pronounced in these types of credits and is, to a greater degree than with other loans, driven by the economic environment in which the debtor's business operates.

During the nine months ended September 30, 2013, CNB recorded a provision for loan losses of \$4.9 million, as compared to a provision for loan losses of \$4.0 million for the nine months ended September 30, 2012. The provision was impacted by one particular commercial mortgage loan that was impaired at December 31, 2012 and then was placed on nonaccrual status during the three months ended March 31, 2013, resulting in an increase in nonperforming assets of \$2.9 million. No loan loss reserve was required for this loan as of March 31, 2013 or December 31, 2012. However, due to a rapid deterioration in the loan collateral value, the Corporation recorded an increase in the provision for loan losses attributable to this impaired loan of \$1.7 million during the second quarter. Subsequently, the Corporation recorded a partial chargeoff on the loan of \$892 thousand, resulting in a recorded investment of \$2.0 million and a specific reserve of \$822 thousand as of September 30, 2013.

A loan modified in a troubled debt restructuring that was nonperforming at December 31, 2012 was partially charged off in the first quarter of 2013, resulting in a decrease in nonperforming assets of \$595 thousand. Additional provisions for loan losses of \$135 thousand and \$128 thousand were recorded for this loan during the first and third quarters of 2013, respectively.



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During the second quarter of 2013, a commercial mortgage loan with a balance of \$1.1 million that was previously modified in a troubled debt restructuring defaulted under its modified terms, resulting in an increase in the provision for loan losses of \$611 thousand. An additional provision for loan losses of \$50 thousand was recorded for this loan during the third quarter of 2013.

A commercial mortgage loan with a carrying value of \$3.3 million defaulted in the second quarter. Based on management's evaluation of the fair value of the associated collateral, no provision for loan losses was required to be recorded for this loan.

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relationship as of June 30, 2013. During the third quarter of 2013, this loan was modified in a troubled debt restructuring, which will result in the Corporation receiving reduced monthly payments that will be applied entirely to the loan's principal balance. The Corporation also obtained an updated appraisal for the loan collateral in October 2013 and, as a result, recorded a provision for loan losses of \$562 thousand as of and for the quarter ended September 30, 2013.

Finally, the Corporation recorded a loan loss recovery of \$1.4 million in the third quarter of 2013 related to an impaired commercial mortgage loan that had been partially charged off prior to January 1, 2013. At the recovery date, the carrying amount of the loan was \$5.2 million, which was satisfied in full by the Corporation's participation in the issuance of a loan at market terms to a new borrower that purchased the property securing the loan.

Management believes that the allowance for loan losses is reasonable and adequate to absorb probable incurred losses in its portfolio at September 30, 2013.

**PREMISES AND EQUIPMENT**

In the second quarter of 2013, the Corporation entered into a contractual commitment to expand its main office facility in Clearfield, Pennsylvania at an approximate cost of \$4 million. Construction has commenced with approximately \$2.2 million in construction-related expenditures incurred as of September 30, 2013. The project is expected to be completed by the end of the first quarter of 2014.

**FUNDING SOURCES**

The Corporation considers deposits, short-term borrowings, and term debt when evaluating funding sources. Traditional deposits continue to be the main source of funds in the Corporation, increasing \$67.3 million from \$1.49 billion at December 31, 2012 to \$1.55 billion at September 30, 2013. The growth in deposits was primarily due to increases in interest-bearing demand deposits of \$37.9 million and savings accounts of \$41.8 million as a result of the Corporation's successful marketing and business development strategies.

Periodically, the Corporation utilizes term borrowings from the Federal Home Loan Bank ( FHLB ) and other lenders to meet funding needs. Management plans to maintain access to short-term and long-term borrowings as an available funding source.

**SHAREHOLDERS' EQUITY AND CAPITAL RATIOS AND METRICS**

The Corporation's capital continued to provide a base for profitable growth through September 30, 2013. Total shareholders' equity was \$130.8 million at September 30, 2013 and \$145.4 million at December 31, 2012. In the first nine months of 2013, the Corporation earned \$12.0 million and declared dividends of \$6.2 million, a dividend payout ratio of 51.8% of net income. The Corporation has also complied with the standards of capital adequacy mandated by the banking regulators. Bank regulators have established risk-based capital requirements designed to measure capital adequacy. Risk-based capital ratios reflect the relative risks of various assets banks hold in their portfolios. A weight category of 0% (lowest risk assets), 20%, 50%, or 100% (highest risk assets) is assigned to each asset on the balance sheet.

The Corporation's capital ratios, book value per share and tangible book value per share as of September 30, 2013 and December 31, 2012 are as follows:

|                                            | September 30, 2013 | December 31, 2012 |
|--------------------------------------------|--------------------|-------------------|
| Total risk-based capital ratio             | 14.96%             | 15.28%            |
| Tier 1 capital ratio                       | 13.71%             | 14.03%            |
| Leverage ratio                             | 8.05%              | 8.06%             |
| Tangible common equity/tangible assets (1) | 6.56%              | 7.63%             |
| Book value per share                       | \$ 10.45           | \$ 11.65          |
| Tangible book value per share (1)          | 9.57               | 10.77             |

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- (1) Tangible common equity, tangible assets and tangible book value per share are non-GAAP financial measures calculated using GAAP amounts. Tangible common equity is calculated by excluding the balance of goodwill from the calculation of shareholders' equity. Tangible assets is calculated by excluding the balance of goodwill from the calculation of total assets. Tangible book value per share is calculated by dividing tangible common equity by the number of shares outstanding. The Corporation believes that these non-GAAP financial measures provide information to investors that is useful in understanding its financial condition because they are additional measures used to assess capital adequacy. Because not all companies use the same calculation of tangible common equity and tangible assets, this presentation may not be comparable to other similarly titled measures calculated by other companies. A reconciliation of these non-GAAP financial measures is provided below (dollars in thousands, except share and per share data).

|                                               | September 30, 2013 | December 31, 2012 |
|-----------------------------------------------|--------------------|-------------------|
| Shareholders' equity                          | \$ 130,766         | \$ 145,364        |
| Less goodwill                                 | 10,946             | 10,946            |
| <b>Tangible common equity</b>                 | <b>\$ 119,820</b>  | <b>\$ 134,418</b> |
| Total assets                                  | \$ 1,837,419       | \$ 1,773,079      |
| Less goodwill                                 | 10,946             | 10,946            |
| Tangible assets                               | \$ 1,826,473       | \$ 1,762,133      |
| Ending shares outstanding                     | 12,514,138         | 12,475,904        |
| Tangible book value per share                 | \$ 9.57            | \$ 10.77          |
| <b>Tangible common equity/tangible assets</b> | <b>6.56%</b>       | <b>7.63%</b>      |

The decrease in tangible common equity/tangible assets, book value per share, and tangible book value per share from December 31, 2012 to September 30, 2013 is primarily attributable to the significant decline in the fair value of the Corporation's available-for-sale investment securities in relation to book value. This decline in fair value of available-for-sale securities was expected given the increases in intermediate and long-term interest rates that occurred in the second and third quarters of 2013.

**RECENT LEGISLATION**

The following section should be read in conjunction with the Supervision and Regulation section of the Corporation's 2012 Form 10-K.

On July 2, 2013, the Federal Reserve Board issued final rules, and on July 9, 2013, the FDIC issued interim final rules that revise existing regulatory capital requirements to incorporate certain revisions to the Basel capital framework, including Basel III, and to implement certain provisions of the Dodd-Frank Act. The final rules seek to strengthen the components of regulatory capital, increase risk-based capital requirements, and make selected changes to the calculation of risk-weighted assets. The final rules, among other things:

revise minimum capital requirements and adjust prompt corrective action thresholds;

revise the components of regulatory capital, add a new minimum common equity Tier 1 capital ratio of 4.5% of risk-weighted assets, increase the minimum Tier 1 capital requirement from 4% to 6%;

retain the existing risk-based capital treatment for 1-4 family residential mortgage exposures;

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permit most banking organizations, including the Corporation, to retain, through a one-time permanent election, the existing capital treatment for accumulated other comprehensive income;

implement a new capital conservation buffer of common equity Tier 1 capital equal to 2.5% of risk-weighted assets, which will be in addition to the 4.5% common equity Tier 1 capital ratio and be phased in over a three year period beginning January 1, 2016 which buffer is generally required to make capital distributions and pay executive bonuses;

increase capital requirements for past-due loans, high volatility commercial real estate exposures, and certain short-term loan commitments;

require the deduction of mortgage servicing assets and deferred tax assets that exceed 10% of common equity Tier 1 capital in each category and 15% of common equity Tier 1 capital in the aggregate; and

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remove references to credit ratings consistent with Dodd-Frank and establish due diligence requirements for securitization exposures. Under the interim and final rules, compliance is required beginning January 1, 2015, for most banking organizations including the Corporation, subject to a transition period for several aspects of the final rules, including the new minimum capital ratio requirements, the capital conservation buffer, and the regulatory capital adjustments and deductions. We are still in the process of assessing the impacts of these complex final and interim final rules; however, we believe we will continue to exceed all estimated well-capitalized regulatory requirements on a fully phased-in basis.

**LIQUIDITY**

Liquidity measures an organization's ability to meet cash obligations as they come due. The consolidated statement of cash flows provides analysis of the Corporation's cash and cash equivalents. Additionally, management considers that portion of the loan and investment portfolio that matures within one year to be part of the Corporation's liquid assets. The Corporation's liquidity is monitored by both management and the ALCO, which establishes and monitors ranges of acceptable liquidity. Management believes the Corporation's current liquidity position is acceptable.

**OFF BALANCE SHEET ACTIVITIES**

Some financial instruments, such as loan commitments, credit lines, letters of credit and overdraft protection, are issued to meet customer financing needs. The contractual amount of financial instruments with off-balance sheet risk was as follows at September 30, 2013 (in thousands):

|                              |                   |
|------------------------------|-------------------|
| Commitments to extend credit | \$ 266,350        |
| Standby letters of credit    | 13,916            |
|                              | <b>\$ 280,266</b> |

**RESULTS OF OPERATIONS****Three Months Ended September 30, 2013 and 2012****OVERVIEW OF THE INCOME STATEMENT**

The Corporation had net income of \$4.7 million in the third quarter of 2013, compared to \$4.6 million for the same period of 2012. The earnings per diluted share were \$0.38 in the third quarter of 2013 and \$0.37 in the third quarter of 2012. As described below, non-interest expenses for the three months ended September 30, 2013 include \$398 thousand associated with merger related expenses.

**INTEREST INCOME AND EXPENSE**

Net interest income totaled \$14.6 million, an increase of \$978 thousand, or 7.2%, over the third quarter of 2012. Total interest and dividend income increased by \$332 thousand, or 1.9%, as compared to the third quarter of 2012. Although the Corporation's earning assets continue to grow, these increases have been offset by decreases in the yield on earning assets resulting from the continued low interest rate environment. Total interest expense decreased \$646 thousand, or 18.7%, as compared to the third quarter of 2012 due to decreases in the cost of deposits.

**PROVISION FOR LOAN LOSSES**

The Corporation recorded a provision for loan losses of \$846 thousand in the second quarter of 2013 compared to \$1.2 million in the third quarter of 2012. As disclosed in the Allowance for Loan Losses section of Management's Discussion and Analysis, in the third quarter of 2013, the Corporation recorded provisions for loan losses associated with certain impaired loans and also recorded a significant loan loss recovery for a commercial mortgage loan.

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Management believes the provision for loan losses was appropriate and the allowance for loan losses is adequate to absorb probable incurred losses in our portfolio as of September 30, 2013.

### **NON-INTEREST INCOME**

Excluding the effects of the securities transactions described below, non-interest income was \$3.1 million for the three months ended September 30, 2013, compared to \$2.7 million for the three months ended September 30, 2012. Net realized gains on available-for-sale securities were \$103 thousand during the three months ended September 30, 2012. Net realized and unrealized gains on trading securities were \$166 thousand and \$275 thousand during the three months ended September 30, 2013 and 2012, respectively.

Wealth and asset management fees increased from \$498 thousand during the three months ended September 30, 2012 to \$615 thousand during the three months ended September 30, 2013 due to increases in assets under management resulting from the Corporation's strategic focus to grow its Wealth and Asset Management Division.

### **NON-INTEREST EXPENSES**

Total non-interest expenses increased \$1.1 million, or 12.3%, during the three months ended September 30, 2013 compared to the three months ended September 30, 2012. Merger costs associated with the Corporation's acquisition of FC Banc Corp. totaled \$398 thousand during the three months ended September 30, 2013. In addition, salaries and benefits expenses increased \$457 thousand, or 9.5%, during the three months ended September 30, 2013 compared to the three months ended September 30, 2012, in part due to routine merit increases, an increase in average full-time equivalent employees, and increases in certain employee benefit expenses, such as health insurance costs, which continue to increase in line with market conditions.

### **INCOME TAX EXPENSE**

Income tax expense was \$2.0 million in the third quarter of 2013 as compared to \$1.8 million in the third quarter of 2012, resulting in effective tax rates of 29.9% and 28.2% for the periods, respectively. The effective rates for the periods differed from the federal statutory rate of 35.0% principally as a result of tax exempt income from securities and loans, earnings from bank owned life insurance, and nondeductible merger costs.

### **AVERAGE BALANCES AND NET INTEREST MARGIN**

The table on the following page presents the average balances and net interest margin for the nine months ended September 30, 2013 and 2012. This information should be reviewed in conjunction with management's discussion and analysis for the results of operations for the nine months ended September 30, 2013 and 2012 that follows the table.

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## CONSOLIDATED YIELD COMPARISONS

## AVERAGE BALANCES AND NET INTEREST MARGIN FOR THE NINE MONTHS ENDED

Dollars in thousands

|                                             | September 30, 2013  |              |                    | September 30, 2012  |              |                    |
|---------------------------------------------|---------------------|--------------|--------------------|---------------------|--------------|--------------------|
|                                             | Average Balance     | Annual Rate  | Interest Inc./Exp. | Average Balance     | Annual Rate  | Interest Inc./Exp. |
| <b>ASSETS:</b>                              |                     |              |                    |                     |              |                    |
| Interest-bearing deposits with other banks  | \$ 4,640            | 0.00%        | \$                 | \$ 3,934            | 0.01%        | \$                 |
| <b>Securities:</b>                          |                     |              |                    |                     |              |                    |
| Taxable (1)                                 | 610,310             | 2.19%        | 10,166             | 601,280             | 2.56%        | 11,226             |
| Tax-Exempt (1,2)                            | 130,672             | 4.54%        | 4,331              | 112,936             | 4.96%        | 3,971              |
| Equity Securities (1,2)                     | 3,554               | 6.79%        | 181                | 2,710               | 3.10%        | 63                 |
| <b>Total securities</b>                     | <b>744,536</b>      | <b>2.61%</b> | <b>14,678</b>      | <b>716,926</b>      | <b>2.93%</b> | <b>15,260</b>      |
| <b>Loans:</b>                               |                     |              |                    |                     |              |                    |
| Commercial (2)                              | 306,810             | 4.77%        | 10,979             | 296,040             | 4.98%        | 11,050             |
| Mortgage (2)                                | 609,602             | 4.76%        | 21,778             | 539,087             | 5.36%        | 21,679             |
| Consumer                                    | 56,333              | 12.77%       | 5,394              | 49,819              | 13.11%       | 4,897              |
| <b>Total loans (3)</b>                      | <b>972,745</b>      | <b>5.23%</b> | <b>38,151</b>      | <b>884,946</b>      | <b>5.67%</b> | <b>37,626</b>      |
| <b>Total earning assets</b>                 | <b>1,721,921</b>    | <b>4.08%</b> | <b>\$ 52,829</b>   | <b>1,605,806</b>    | <b>4.45%</b> | <b>\$ 52,886</b>   |
| <b>Non interest-bearing assets:</b>         |                     |              |                    |                     |              |                    |
| Cash and due from banks                     | 25,898              |              |                    | 28,525              |              |                    |
| Premises and equipment                      | 24,847              |              |                    | 24,088              |              |                    |
| Other assets                                | 57,246              |              |                    | 55,679              |              |                    |
| Allowance for loan losses                   | (15,055)            |              |                    | (13,252)            |              |                    |
| <b>Total non interest-bearing assets</b>    | <b>92,936</b>       |              |                    | <b>95,040</b>       |              |                    |
| <b>TOTAL ASSETS</b>                         | <b>\$ 1,814,857</b> |              |                    | <b>\$ 1,700,846</b> |              |                    |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY:</b> |                     |              |                    |                     |              |                    |
| Demand - interest-bearing                   | \$ 366,768          | 0.39%        | \$ 1,061           | \$ 306,317          | 0.51%        | \$ 1,176           |
| Savings                                     | 793,949             | 0.48%        | 2,851              | 730,731             | 0.81%        | 4,421              |
| Time                                        | 201,890             | 1.29%        | 1,950              | 234,139             | 1.66%        | 2,922              |
| <b>Total interest-bearing deposits</b>      | <b>1,362,607</b>    | <b>0.57%</b> | <b>5,862</b>       | <b>1,271,187</b>    | <b>0.89%</b> | <b>8,519</b>       |
| Short-term borrowings                       | 24,430              | 0.19%        | 34                 | 9,924               | 0.16%        | 12                 |
| Long-term borrowings                        | 75,018              | 4.48%        | 2,523              | 74,390              | 4.31%        | 2,406              |
| Subordinated debentures                     | 20,620              | 3.77%        | 583                | 20,620              | 3.92%        | 606                |
| <b>Total interest-bearing liabilities</b>   | <b>1,482,675</b>    | <b>0.81%</b> | <b>\$ 9,002</b>    | <b>1,376,121</b>    | <b>1.12%</b> | <b>\$ 11,543</b>   |
| Demand - non interest-bearing               | 175,081             |              |                    | 162,898             |              |                    |
| Other liabilities                           | 17,526              |              |                    | 22,791              |              |                    |

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|                                                   |                     |                  |                     |                  |
|---------------------------------------------------|---------------------|------------------|---------------------|------------------|
| Total liabilities                                 | 1,675,282           |                  | 1,561,810           |                  |
| Shareholders' equity                              | 139,575             |                  | 139,036             |                  |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b> | <b>\$ 1,814,857</b> |                  | <b>\$ 1,700,846</b> |                  |
| Interest income/Earning assets                    | 4.08%               | \$ 52,829        | 4.45%               | \$ 52,886        |
| Interest expense/Interest-bearing liabilities     | 0.81%               | 9,002            | 1.12%               | 11,543           |
| <b>Net interest spread</b>                        | <b>3.27%</b>        | <b>\$ 43,827</b> | <b>3.33%</b>        | <b>\$ 41,343</b> |
| Interest income/Earning assets                    | 4.08%               | 52,829           | 4.45%               | 52,886           |
| Interest expense/Earning assets                   | 0.70%               | 9,002            | 0.96%               | 11,543           |
| <b>Net interest margin</b>                        | <b>3.38%</b>        | <b>\$ 43,827</b> | <b>3.49%</b>        | <b>\$ 41,343</b> |

- (1) Includes unamortized discounts and premiums. Average balance is computed using the carrying value of securities. The average yield has been computed using the historical amortized cost average balance for available for sale securities.
- (2) Average yields are stated on a fully taxable equivalent basis.
- (3) Average outstanding includes the average balance outstanding of all non-accrual loans. Loans consist of the average of total loans less average unearned income. The amount of loan fees included in the interest income on loans is not material.



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**Nine Months Ended September 30, 2013 and 2012**

**OVERVIEW OF THE INCOME STATEMENT**

The Corporation had net income of \$12.0 million for the nine months ended September 30, 2013, compared to \$13.2 million for the same period of 2012. The earnings per diluted share were \$0.96 for the nine months ended September 30, 2013 and \$1.06 for the nine months ended September 30, 2012. The return on average assets and return on average equity for the nine months ended September 30, 2013 are 0.88% and 11.42%, respectively, compared to 1.04% and 12.70%, respectively, for the same period of 2012. As described below, non-interest expenses for the nine months ended September 30, 2013 include \$1.3 million associated with merger related expenses.

**INTEREST INCOME AND EXPENSE**

During the nine months ended September 30, 2013, net interest income increased \$2.3 million, or 5.8%, compared to the nine months ended September 30, 2012. The Corporation's net interest margin on a fully tax equivalent basis was 3.38% for the nine months ended September 30, 2013, compared to 3.49% for the nine months ended September 30, 2012.

Total interest and dividend income was \$50.9 million for the nine months ended September 30, 2013, a decrease of \$237 thousand, or 0.5%, as compared to the nine months ended September 30, 2012. Although the Corporation's earning assets continue to grow, these increases have been offset by decreases in the yield on earning assets resulting from the continued low interest rate environment. During the nine months ended September 30, 2013, total interest expense decreased \$2.5 million, or 22.0%, as compared to the nine months ended September 30, 2012 due to decreases in the cost of deposits.

**PROVISION FOR LOAN LOSSES**

The Corporation recorded a provision for loan losses of \$4.9 million during the nine months ended September 30, 2013 compared to \$4.0 million during the nine months ended September 30, 2012. As disclosed in the Allowance for Loan Losses section of Management's Discussion and Analysis, in the first nine months of 2013, the Corporation recorded a provision for loan losses associated with certain impaired loans and also recorded a significant loan loss recovery for a commercial mortgage loan.

Management believes the provision for loan losses was appropriate and the allowance for loan losses is adequate to absorb probable incurred losses in our portfolio as of September 30, 2013.

**NON-INTEREST INCOME**

Excluding the effects of the securities transactions described below, non-interest income was \$9.3 million for the nine months ended September 30, 2013, compared to \$7.9 million for the nine months ended September 30, 2012. Net realized gains on available-for-sale securities were \$328 thousand during the nine months ended September 30, 2013, and \$1.4 million during the nine months ended September 30, 2012. Net realized and unrealized gains on trading securities were \$497 thousand and \$455 thousand during the nine months ended September 30, 2013 and 2012, respectively.

During the nine months ended September 30, 2013, the Corporation recorded \$1.4 million in income from bank owned life insurance policies, including \$576 thousand representing the excess of the face value of certain policies over their cash surrender values resulting from the maturity of the policies.

Wealth and asset management fees increased from \$1.3 million during the nine months ended September 30, 2012 to \$1.7 million during the nine months ended September 30, 2013 due to increases in assets under management resulting from the Corporation's strategic focus to grow its Wealth and Asset Management Division.

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**NON-INTEREST EXPENSES**

Total non-interest expenses increased \$3.8 million, or 13.9%, during the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. Merger costs associated with the Corporation's acquisition of FC Banc Corp. totaled \$1.3 million during the nine months ended September 30, 2013. Salaries and benefits expenses increased \$1.6 million, or 11.6%, during the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012, in part due to routine merit increases, an increase in average full-time equivalent employees, and increases in certain employee benefit expenses, such as health insurance costs, which continue to increase in line with market conditions. Net occupancy expenses increased \$438 thousand, or 12.9%, during the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012, as a result of anticipated increases repair, maintenance, and utility expenses, as well as increases in depreciation expense for recently completed projects and asset purchases.

**INCOME TAX EXPENSE**

Income tax expense was \$4.4 million for the nine months ended September 30, 2013 as compared to \$5.0 million for the nine months ended September 30, 2012, resulting in effective tax rates of 26.7% and 27.6% for the periods, respectively. The effective rates for the periods differed from the federal statutory rate of 35.0% principally as a result of tax exempt income from securities and loans, earnings from bank owned life insurance, and nondeductible merger costs.

**CRITICAL ACCOUNTING POLICIES**

The Corporation's accounting and reporting policies are in accordance with GAAP and conform to general practices within the financial services industry. Accounting and reporting practices for the allowance for loan losses and fair value of securities are deemed critical since they involve the use of estimates and require significant management judgments. Application of assumptions different than those used by management could result in material changes in the Corporation's financial position or results of operations. Note 1 (Summary of Significant Accounting Policies), Note 3 (Securities), and Note 4 (Loans), of the Corporation's 2012 Form 10-K, provide detail with regard to the Corporation's accounting for the allowance for loan losses and fair value of securities. There have been no significant changes in the application of accounting policies since December 31, 2012.

**ITEM 3**

**QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

As a financial institution, the Corporation's primary source of market risk is interest rate risk, which is the exposure to fluctuations in the Corporation's future earnings resulting from changes in interest rates. This exposure is correlated to the repricing characteristics of the Corporation's portfolio of assets and liabilities. Each asset or liability reprices either at maturity or during the life of the instrument.

The principal purpose of asset/liability management is to maximize current and future net interest income within acceptable levels of interest rate risk while satisfying liquidity and capital requirements. Net interest income is enhanced by increasing the net interest margin and by the growth in earning assets. As a result, the primary goal of interest rate risk management is to maintain a balance between risk and reward such that net interest income is maximized while risk is maintained at an acceptable level.

The Corporation uses an asset-liability management model to measure the effect of interest rate changes on its net interest income. The Corporation's management also reviews asset-liability maturity gap and repricing analyses regularly. The Corporation does not always attempt to achieve a precise match between interest sensitive assets and liabilities because it believes that an actively managed amount of interest rate risk is inherent and appropriate in the management of the Corporation's profitability.

Asset-liability modeling techniques and simulation involve assumptions and estimates that inherently cannot be measured with precision. Key assumptions in these analyses include maturity and repricing characteristics of assets and liabilities, prepayments on amortizing assets, non-maturing deposit sensitivity, and loan and deposit pricing. These assumptions are

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inherently uncertain due to the timing, magnitude, and frequency of rate changes and changes in market conditions and management strategies, among other factors. However, the analyses are useful in quantifying risk and provide a relative gauge of the Corporation's interest rate risk position over time.

Management reviews interest rate risk on a quarterly basis and reports to the ALCO. This review includes earnings shock scenarios whereby interest rates are immediately increased and decreased by 100, 300, and 400 basis points. These scenarios, detailed in the table below, indicate that there would not be a significant variance in net interest income over a one-year period due to interest rate changes; however, actual results could vary significantly. At September 30, 2013 and December 31, 2012, all interest rate risk levels according to the model were within the tolerance limits of ALCO approved policy of +/- 25%. In addition, the table does not take into consideration changes that management would make to realign its assets and liabilities in the event of an unexpected changing interest rate environment. Due to the historically low interest rate environment, the -300 and -400 scenarios have been excluded from the table.

| September 30, 2013 |                 | December 31, 2012 |                 |
|--------------------|-----------------|-------------------|-----------------|
| Change in          | % Change in Net | Change in         | % Change in Net |
| Basis Points       | Interest Income | Basis Points      | Interest Income |
| 400                | -2.7%           | 400               | -0.5%           |
| 300                | -0.6%           | 300               | -0.8%           |
| 100                | 1.5%            | 100               | 2.3%            |
| (100)              | -4.4%           | (100)             | -4.0%           |

**ITEM 4****CONTROLS AND PROCEDURES**

As of the end of the period covered by this quarterly report, an evaluation was carried out under the supervision and with the participation of the Corporation's management, including the Chief Executive Officer and Principal Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934) ( "Exchange Act" ). Based on their evaluation, our Chief Executive Officer and Principal Financial Officer have concluded that the Corporation's disclosure controls and procedures were effective as of the end of the period covered by this quarterly report to ensure that information required to be disclosed by the Corporation in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. There were no changes in the Corporation's internal control over financial reporting that occurred during the period covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

**Table of Contents****PART II OTHER INFORMATION**

ITEM 1. LEGAL PROCEEDINGS None

ITEM 1A. RISK FACTORS Management of the Corporation urges the reader to understand and consider the following updated risk factor in addition to those disclosed in the Corporation's Annual Report on Form 10-K for the fiscal year ended December 31, 2012 filed with the Securities and Exchange Commission on March 8, 2013.

*The risks presented by acquisitions could adversely affect our financial condition and result of operations.*

Any acquisitions, including our completed acquisition of FC Banc Corp., will be accompanied by the risks commonly encountered in acquisitions including, among other things: our ability to realize anticipated cost savings and avoid unanticipated costs relating to the merger, the difficulty of integrating operations and personnel, the potential disruption of our or the acquired company's ongoing business, the inability of our management to maximize our financial and strategic position, the inability to maintain uniform standards, controls, procedures and policies, and the impairment of relationships with the acquired company's employees and customers as a result of changes in ownership and management. These risks may prevent the Corporation from fully realizing the anticipated benefits of an acquisition or cause the realization of such benefits to take longer than expected.

ITEM 6. EXHIBITS

| Exhibit | Description                                                                                                                                                                                                                                                  |
|---------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| No.     |                                                                                                                                                                                                                                                              |
| 2.1     | Agreement and Plan of Merger, dated as of March 26, 2013, by and between the Corporation and FC Banc Corp., filed as Exhibit 2.1 to the Corporation's Current Report on Form 8-K, filed with the SEC on March 27, 2013 and incorporated herein by reference. |
| 3.1     | Amended and Restated Articles of Incorporation of the Corporation, filed as Appendix B to the 2005 Proxy Statement, filed with the SEC on March 24, 2006, and incorporated herein by reference.                                                              |
| 3.2     | By-Laws of the Corporation, as amended and restated, filed as Appendix C to the 2005 Proxy Statement, filed with the SEC on March 24, 2006, and incorporated herein by reference.                                                                            |
| 31.1    | Rule 13a-14(a)/15d-14(a) Certification of the Principal Executive Officer                                                                                                                                                                                    |
| 31.2    | Rule 13a-14(a)/15d-14(a) Certification of the Principal Financial Officer                                                                                                                                                                                    |
| 32.1    | Section 1350 Certification                                                                                                                                                                                                                                   |
| 32.2    | Section 1350 Certification                                                                                                                                                                                                                                   |
| 101.INS | XBRL Instance Document                                                                                                                                                                                                                                       |
| 101.SCH | XBRL Taxonomy Extension Schema Document                                                                                                                                                                                                                      |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document                                                                                                                                                                                                        |
| 101.DEF | XBRL Taxonomy Extension Definitions Linkbase Document                                                                                                                                                                                                        |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document                                                                                                                                                                                                              |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document                                                                                                                                                                                                       |

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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.

CNB FINANCIAL CORPORATION  
(Registrant)

DATE: November 7, 2013

/s/ Joseph B. Bower, Jr.  
Joseph B. Bower, Jr.  
President and Director  
(Principal Executive Officer)

DATE: November 7, 2013

/s/ Brian W. Wingard  
Brian W. Wingard  
Treasurer  
(Principal Financial Officer)

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## EXHIBIT INDEX

| Exhibit |                                                                                                                                                                                                                                                              |
|---------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
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| 32.1    | Section 1350 Certification                                                                                                                                                                                                                                   |
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| 101.INS | XBRL Instance Document                                                                                                                                                                                                                                       |
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| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document                                                                                                                                                                                                              |
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