

OHIO VALLEY BANC CORP  
Form 10-Q  
August 10, 2015

United States  
Securities and Exchange Commission  
Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2015

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 0-20914

OHIO VALLEY BANC CORP.  
(Exact name of registrant as specified in its charter)

Ohio  
(State of Incorporation)

31-1359191  
(I.R.S. Employer Identification No.)

420 Third Avenue  
Gallipolis, Ohio  
(Address of principal executive offices)

45631  
(ZIP Code)

(740) 446-2631  
(Issuer's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate 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):

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Large accelerated   
filer  
Non-accelerated filer

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 common shares of the registrant outstanding as of August 10, 2015 was 4,117,675.

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## OHIO VALLEY BANC CORP.

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## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

OHIO VALLEY BANC CORP.  
CONSOLIDATED BALANCE SHEETS  
(dollars in thousands, except share and per share data)

|   | June 30,<br>2015<br>UNAUDITED | December<br>31,<br>2014 |
|---|-------------------------------|-------------------------|
| <b>ASSETS</b>   |                               |                         |
| Cash and noninterest-bearing deposits with banks  | \$ 10,587                     | \$9,315                 |
| Interest-bearing deposits with banks  | 41,493                        | 21,662                  |
| Total cash and cash equivalents   | 52,080                        | 30,977                  |
| Certificates of deposit in financial institutions                                       | 980                           | 980                     |
| Securities available for sale   | 84,963                        | 85,236                  |
| Securities held to maturity<br>(estimated fair value: 2015 - \$22,538; 2014 - \$23,570) | 21,914                        | 22,820                  |
| Federal Home Loan Bank and Federal Reserve Bank stock                                   | 6,576                         | 6,576                   |
| Total loans   | 592,899                       | 594,768                 |
| Less: Allowance for loan losses   | (7,444 )                      | (8,334 )                |
| Net loans   | 585,455                       | 586,434                 |
| Premises and equipment, net   | 9,991                         | 9,195                   |
| Other real estate owned   | 1,590                         | 1,525                   |
| Accrued interest receivable   | 1,799                         | 1,806                   |
| Goodwill  | 1,267                         | 1,267                   |
| Bank owned life insurance and annuity assets  | 25,926                        | 25,612                  |
| Other assets  | 7,832                         | 6,240                   |
| Total assets  | \$ 800,373                    | \$778,668               |
| <b>LIABILITIES</b>  |                               |                         |
| Noninterest-bearing deposits  | \$ 172,419                    | \$161,794               |
| Interest-bearing deposits   | 493,869                       | 485,036                 |
| Total deposits  | 666,288                       | 646,830                 |
| Other borrowed funds  | 24,322                        | 24,972                  |
| Subordinated debentures   | 8,500                         | 8,500                   |
| Accrued liabilities   | 12,378                        | 12,150                  |
| Total liabilities   | 711,488                       | 692,452                 |
| COMMITMENTS AND CONTINGENT LIABILITIES (See Note 5)                                     | ----                          | ----                    |
| <b>SHAREHOLDERS' EQUITY</b>   |                               |                         |
| Common stock (\$1.00 stated value per share, 10,000,000 shares)                         | 4,777                         | 4,777                   |

|  |            |            |
|--|------------|------------|
| authorized; 4,777,414 shares issued)       |            |            |
| Additional paid-in capital                 | 35,318     | 35,318     |
| Retained earnings                          | 63,971     | 60,873     |
| Accumulated other comprehensive income     | 531        | 960        |
| Treasury stock, at cost (659,739 shares)   | (15,712 )  | (15,712 )  |
| Total shareholders' equity                 | 88,885     | 86,216     |
| Total liabilities and shareholders' equity | \$ 800,373 | \$ 778,668 |

See accompanying notes to consolidated financial statements

OHIO VALLEY BANC CORP.  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)  
(dollars in thousands, except per share data)

|  | Three months ended<br>June 30, |         | Six months ended<br>June 30, |          |
|--|--------------------------------|---------|------------------------------|----------|
|  | 2015                           | 2014    | 2015                         | 2014     |
| <b>Interest and dividend income:</b>                     |                                |         |                              |          |
| Loans, including fees                                    | \$8,150                        | \$8,223 | \$17,049                     | \$17,037 |
| <b>Securities</b>  |                                |         |                              |          |
| Taxable  | 453                            | 445     | 902                          | 851      |
| Tax exempt   | 134                            | 139     | 273                          | 275      |
| Dividends  | 72                             | 80      | 146                          | 166      |
| Other Interest   | 57                             | 38      | 123                          | 104      |
|  | 8,866                          | 8,925   | 18,493                       | 18,433   |
| <b>Interest expense:</b>                                 |                                |         |                              |          |
| Deposits   | 555                            | 578     | 1,090                        | 1,151    |
| Other borrowed funds                                     | 120                            | 119     | 241                          | 231      |
| Subordinated debentures                                  | 42                             | 41      | 83                           | 82       |
|  | 717                            | 738     | 1,414                        | 1,464    |
| Net interest income                                      | 8,149                          | 8,187   | 17,079                       | 16,969   |
| Provision for loan losses                                | 799                            | 1,386   | 721                          | 1,880    |
| Net interest income after provision for loan losses      | 7,350                          | 6,801   | 16,358                       | 15,089   |
| <b>Noninterest income:</b>                               |                                |         |                              |          |
| Service charges on deposit accounts                      | 393                            | 395     | 746                          | 786      |
| Trust fees   | 57                             | 59      | 115                          | 114      |
| Income from bank owned life insurance and annuity assets | 138                            | 171     | 314                          | 330      |
| Mortgage banking income                                  | 55                             | 57      | 114                          | 115      |
| Electronic refund check / deposit fees                   | 255                            | 414     | 2,350                        | 3,062    |
| Debit / credit card interchange income                   | 627                            | 548     | 1,165                        | 1,052    |
| Gain (loss) on other real estate owned                   | 45                             | 4       | 60                           | (8 )     |
| Gain on sale of securities                               | 135                            | ----    | 135                          | ----     |
| Gain on sale of ProAlliance Corporation                  | ----                           | ----    | ----                         | 135      |
| Other  | 212                            | 264     | 407                          | 444      |
|  | 1,917                          | 1,912   | 5,406                        | 6,030    |
| <b>Noninterest expense:</b>                              |                                |         |                              |          |
| Salaries and employee benefits                           | 4,426                          | 4,235   | 8,826                        | 8,612    |
| Occupancy  | 388                            | 391     | 790                          | 789      |
| Furniture and equipment                                  | 194                            | 152     | 372                          | 332      |
| FDIC insurance   | 132                            | 113     | 298                          | 240      |
| Data processing  | 362                            | 293     | 730                          | 614      |
| Foreclosed assets  | 62                             | 41      | 97                           | 102      |
| Other  | 1,990                          | 1,772   | 3,868                        | 3,603    |
|  | 7,554                          | 6,997   | 14,981                       | 14,292   |
| Income before income taxes                               | 1,713                          | 1,716   | 6,783                        | 6,827    |

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|                            |         |         |         |         |
|----------------------------|---------|---------|---------|---------|
| Provision for income taxes | 303     | 372     | 1,749   | 1,919   |
| NET INCOME                 | \$1,410 | \$1,344 | \$5,034 | \$4,908 |
| Earnings per share         | \$.34   | \$.33   | \$1.22  | \$1.20  |

See accompanying notes to consolidated financial statements

OHIO VALLEY BANC CORP.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)  
(dollars in thousands)

|  | Three months ended |         | Six months ended |         |
|--|--------------------|---------|------------------|---------|
|  | June 30,           |         | June 30,         |         |
|  | 2015               | 2014    | 2015             | 2014    |
| Net Income   | \$1,410            | \$1,344 | \$5,034          | \$4,908 |
| Other comprehensive income:                                |                    |         |                  |         |
| Change in unrealized gain on available for sale securities | (971 )             | 716     | (516 )           | 1,162   |
| Reclassification adjustment for realized (gains)           | (135 )             | ----    | (135 )           | ----    |
|  | (1,106 )           | 716     | (651 )           | 1,162   |
| Related tax (expense) benefit                              | 376                | (243 )  | 222              | (394 )  |
| Total other comprehensive income, net of tax               | (730 )             | 473     | (429 )           | 768     |
| Total comprehensive income                                 | \$680              | \$1,817 | \$4,605          | \$5,676 |

See accompanying notes to consolidated financial statements



OHIO VALLEY BANC CORP.  
 CONDENSED CONSOLIDATED STATEMENTS OF CHANGES  
 IN SHAREHOLDERS' EQUITY (UNAUDITED)  
 (dollars in thousands, except share and per share data)

|  | Three months ended |          | Six months ended |          |
|--|--------------------|----------|------------------|----------|
|  | June 30,           |          | June 30,         |          |
|  | 2015               | 2014     | 2015             | 2014     |
| Balance at beginning of period         | \$89,276           | \$83,417 | \$86,216         | \$80,419 |
| Net income                             | 1,410              | 1,344    | 5,034            | 4,908    |
| Other comprehensive income, net of tax | (730 )             | 473      | (429 )           | 768      |
| Cash dividends                         | (1,071 )           | (861 )   | (1,936 )         | (1,722 ) |
| Balance at end of period               | \$88,885           | \$84,373 | \$88,885         | \$84,373 |
| Cash dividends per share               | \$.26              | \$.21    | \$.47            | \$.42    |

See accompanying notes to consolidated financial statements

OHIO VALLEY BANC CORP.  
CONDENSED CONSOLIDATED STATEMENTS OF  
CASH FLOWS (UNAUDITED)  
(dollars in thousands)

|   | Six months ended<br>June 30, |           |
|---|------------------------------|-----------|
|   | 2015                         | 2014      |
| Net cash provided by operating activities:                | \$4,760                      | \$6,606   |
| <b>Investing activities:</b>                              |                              |           |
| Proceeds from maturities of securities available for sale | 7,783                        | 7,326     |
| Purchases of securities available for sale                | (17,035 )                    | (8,041 )  |
| Proceeds from maturities of securities held to maturity   | 1,501                        | 475       |
| Purchases of securities held to maturity                  | (625 )                       | (610 )    |
| Proceeds from sale of available for sale securities       | 8,792                        | ----      |
| Redemptions of Federal Home Loan Bank stock               | ----                         | 1,200     |
| Net change in loans                                       | (234 )                       | (22,191 ) |
| Proceeds from sale of other real estate owned             | 487                          | 107       |
| Purchases of premises and equipment                       | (1,198 )                     | (783 )    |
| Net cash provided by (used in) investing activities       | (529 )                       | (22,517 ) |
| <b>Financing activities:</b>                              |                              |           |
| Change in deposits  | 19,458                       | 8,780     |
| Cash dividends  | (1,936 )                     | (1,722 )  |
| Proceeds from Federal Home Loan Bank borrowings           | ----                         | 3,633     |
| Repayment of Federal Home Loan Bank borrowings            | (650 )                       | (530 )    |
| Change in other short-term borrowings                     | ----                         | 50        |
| Net cash provided by financing activities                 | 16,872                       | 10,211    |
| Change in cash and cash equivalents                       | 21,103                       | (5,700 )  |
| Cash and cash equivalents at beginning of period          | 30,977                       | 28,344    |
| Cash and cash equivalents at end of period                | \$52,080                     | \$22,644  |
| <b>Supplemental disclosure:</b>                           |                              |           |
| Cash paid for interest                                    | \$1,352                      | \$1,439   |
| Cash paid for income taxes                                | 2,450                        | 2,731     |
| Transfers from loans to other real estate owned           | 492                          | 484       |
| Other real estate owned sales financed by the Bank        | 135                          | 65        |

See accompanying notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(dollars in thousands, except per share data)

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**BASIS OF PRESENTATION:** The accompanying consolidated financial statements include the accounts of Ohio Valley Banc Corp. (“Ohio Valley”) and its wholly-owned subsidiaries, The Ohio Valley Bank Company (the “Bank”), Loan Central, Inc. (“Loan Central”), a consumer finance company, Ohio Valley Financial Services Agency, LLC (“Ohio Valley Financial Services”), an insurance agency, and OVBC Captive, Inc. (“the Captive”), a limited purpose property and casualty insurance company. Ohio Valley and its subsidiaries are collectively referred to as the “Company”. All material intercompany accounts and transactions have been eliminated in consolidation.

These interim financial statements are prepared by the Company without audit and reflect all adjustments of a normal recurring nature which, in the opinion of management, are necessary to present fairly the consolidated financial position of the Company at June 30, 2015, and its results of operations and cash flows for the periods presented. The results of operations for the six months ended June 30, 2015 are not necessarily indicative of the operating results to be anticipated for the full fiscal year ending December 31, 2015. The accompanying consolidated financial statements do not purport to contain all the necessary financial disclosures required by accounting principles generally accepted in the United States of America that might otherwise be necessary in the circumstances. The Annual Report of the Company for the year ended December 31, 2014 contains consolidated financial statements and related notes which should be read in conjunction with the accompanying consolidated financial statements.

As previously reported, the Internal Revenue Service proposed that Loan Central, as a tax return preparer, be assessed a penalty for allegedly negotiating or endorsing checks issued by the U.S. Treasury to taxpayers. The penalty would amount to approximately \$1.2 million. Loan Central appealed this matter within the Internal Revenue Service. Loan Central was notified that the Appeals Office would not concede the penalty, and the penalty had been assessed. The Company will have to resolve the matter through the judicial system. Based on consultation with legal counsel, management remains confident that it is highly unlikely that the penalty recommendation will be sustained. Therefore, the Company did not recognize any interest and/or penalties related to this matter for the periods presented.

The consolidated financial statements for 2014 have been reclassified to conform to the presentation for 2015. These reclassifications had no effect on the net results of operations or shareholders’ equity.

**USE OF ESTIMATES IN THE PREPARATION OF FINANCIAL STATEMENTS:** To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ.

**INDUSTRY SEGMENT INFORMATION:** Internal financial information is primarily reported and aggregated in two lines of business, banking and consumer finance.

**EARNINGS PER SHARE:** Earnings per share are computed based on net income divided by the weighted average number of common shares outstanding during the period. The weighted average common shares outstanding were 4,117,675 for the three and six months ended June 30, 2015 and 4,098,753 for the three and six months ended June 30, 2014. Ohio Valley had no dilutive effect and no potential common shares issuable under stock options or other agreements for any period presented.

**NEW ACCOUNTING PRONOUNCEMENTS:** In January 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-04, “Receivables – Troubled Debt Restructurings by Creditors

(Subtopic 310-40)” (ASU 2014-04). The amendments in ASU 2014-04 clarify the circumstances under which an in substance repossession or foreclosure occurs and when a creditor is considered to have received physical possession of a residential real estate property collateralizing a residential real estate loan. The amendments in ASU 2014-04 also require interim and annual disclosure of the amount of foreclosed residential real estate property held by the creditor and the recorded investment in loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. ASU 2014-04 is effective for reporting periods beginning after December 15, 2014. The effect of adopting ASU 2014-04 did not have a material effect on the Company’s financial statements.

In June 2014, the FASB issued ASU 2014-11 “Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures”. The amendments in ASU 2014-11 change the accounting for repurchase-to-maturity transactions and linked repurchase financings to secured borrowing accounting, which is consistent with the accounting for other repurchase agreements. The amendments also require two new disclosures. The first disclosure requires an entity to disclose information on transfers accounted for as sales in transactions that are economically similar to repurchase agreements. The second disclosure provides increased transparency about the types of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. 2014-11 is effective for reporting periods beginning after December 15, 2014. The effect of adopting ASU 2014-11 did not have a material effect on the Company’s financial statements.

In June 2014, the FASB issued ASU 2014-12 “Compensation – Stock Compensation (Topic 718)”. ASU 2014-12 clarifies that entities should treat performance targets that can be met after the requisite service period of a share-based payment award as performance conditions that affect vesting. Therefore, an entity would not record compensation expense (measured as of the grant date without taking into account the effect of the performance target) related to an award for which transfer to the employee is contingent on the entity’s satisfaction of a performance target until it becomes probable that the performance target will be met. No new disclosures are required under ASU 2014-12. The guidance is effective for reporting periods beginning after December 15, 2015. The effect of adopting ASU 2014-12 is not expected to have a material effect on the Company’s financial statements.

#### NOTE 2 – FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (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. There are three levels of inputs that may be used to measure fair values:

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 following is a description of the Company’s valuation methodologies used to measure and disclose the fair values of its financial assets and liabilities on a recurring or nonrecurring basis:

Securities: The fair values for securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). During times when trading is more liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations.

**Impaired Loans:** At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for loan losses. For collateral dependent loans, fair value is commonly based on recent real estate appraisals. 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 independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

**Other Real Estate Owned:** Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals. 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 independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Appraisals for both collateral-dependent impaired loans and other real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, a member of management reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with management's own assumptions of fair value based on factors that include recent market data or industry-wide statistics. On an as-needed basis, the Company reviews the fair value of collateral, taking into consideration current market data, as well as all selling costs that typically approximate 10%.

#### Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below:

|  | Fair Value Measurements at June 30,<br>2015 Using                                   |   |  |
|--|---|---|--|
|  | Quoted<br>Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Assets:  |   |   |  |
| U.S. Government sponsored entity securities    | ----  | \$8,986   | ----   |
| Agency mortgage-backed securities, residential | ----  | 75,977  | ----   |
|  | Fair Value Measurements at December<br>31, 2014, Using                              |   |  |
|  | Quoted<br>Prices in   | Significant<br>Other                                      | Significant<br>Unobservable                        |

|  | Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level 1) | Observable<br>Inputs<br>(Level 2) | Inputs<br>(Level 3) |
|--|--|-----------------------------------|---------------------|
| Assets:  |  |                                   |                     |
| U.S. Government sponsored entity securities    | ----   | \$8,917                           | ----                |
| Agency mortgage-backed securities, residential | ----   | 76,319                            | ----                |

There were no transfers between Level 1 and Level 2 during 2015 or 2014.





2014, and a decrease of \$127 in provision expense during the six months ended June 30, 2014, with \$157 in additional charge-offs recognized. At December 31, 2014, the recorded investment of impaired loans measured for impairment using the fair value of collateral for collateral-dependent loans totaled \$12,773, with a corresponding valuation allowance of \$3,292.

Other real estate owned that was measured at fair value less costs to sell at June 30, 2015 and December 31, 2014 had a net carrying amount of \$1,147, which is made up of the outstanding balance of \$2,217, net of a valuation allowance of \$1,070 at December 31, 2014. There were no corresponding write downs during the three and six months ended June 30, 2015 and 2014. There was \$88 in net appreciation during 2014.

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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 June 30, 2015 and December 31, 2014:

| June 30, 2015             | Fair Value | Valuation Technique(s) | Unobservable Input(s)     | Range       | (Weighted Average) |
|---------------------------|------------|------------------------|---------------------------|-------------|--------------------|
| Impaired loans:           |            |                        |                           |             |                    |
| Commercial real estate:   |            |                        |                           |             |                    |
| Owner-occupied            | \$936      | Sales approach         | Adjustment to comparables | 9.0% to 62% | 28%                |
| Nonowner-occupied         | 2,672      | Sales approach         | Adjustment to comparables | 0% to 12.5% | 5.7%               |
| Other real estate owned:  |            |                        |                           |             |                    |
| Commercial real estate:   |            |                        |                           |             |                    |
| Construction              | 1,147      | Sales approach         | Adjustment to comparables | 5% to 35%   | 18%                |
| December 31, 2014         |            |                        |                           |             |                    |
| December 31, 2014         | Fair Value | Valuation Technique(s) | Unobservable Input(s)     | Range       | (Weighted Average) |
| Impaired loans:           |            |                        |                           |             |                    |
| Commercial real estate:   |            |                        |                           |             |                    |
| Owner-occupied            | \$ 1,679   | Sales approach         | Adjustment to comparables | 0.3% to 62% | 18%                |
|                           |            | Income approach        | Capitalization Rate       | 10%         | 10%                |
| Nonowner-occupied         | 2,597      | Income approach        | Capitalization Rate       | 6.5%        | 6.5%               |
| Nonowner-occupied         | 2,673      | Sales approach         | Adjustment to comparables | 0% to 12.5% | 5.7%               |
| Commercial and industrial | 2,532      | Sales approach         | Adjustment to comparables | 10% to 30%  | 21.42%             |
| Other real estate owned:  |            |                        |                           |             |                    |
| Commercial real estate:   |            |                        |                           |             |                    |
| Construction              | 1,147      | Sales approach         | Adjustment to comparables | 5% to 35%   | 18%                |

The carrying amounts and estimated fair values of financial instruments at June 30, 2015 and December 31, 2014 are as follows:

|   | Carrying Value | Fair Value Measurements at June 30, 2015 Using: |         |         |          |
|---|----------------|---|---------|---------|----------|
|   |                | Level 1   | Level 2 | Level 3 | Total    |
| Financial Assets:                                 |                |   |         |         |          |
| Cash and cash equivalents                         | \$52,080       | \$52,080  | \$---   | \$---   | \$52,080 |
| Certificates of deposit in financial institutions | 980            | ---   | 980     | ---     | 980      |
| Securities available for sale                     | 84,963         | ---   | 84,963  | ---     | 84,963   |
| Securities held to maturity                       | 21,914         | ---   | 11,372  | 11,166  | 22,538   |

## Federal Home Loan Bank and

|                             |         |      |      |         |         |
|-----------------------------|---------|------|------|---------|---------|
| Federal Reserve Bank stock  | 6,576   | N/A  | N/A  | N/A     | N/A     |
| Loans, net                  | 585,455 | ---- | ---- | 590,457 | 590,457 |
| Accrued interest receivable | 1,799   | ---- | 215  | 1,584   | 1,799   |

## Financial liabilities:

|                          |         |         |         |      |         |
|--------------------------|---------|---------|---------|------|---------|
| Deposits                 | 666,288 | 171,656 | 493,906 | ---- | 665,562 |
| Other borrowed funds     | 24,322  | ----    | 23,810  | ---- | 23,810  |
| Subordinated debentures  | 8,500   | ----    | 5,068   | ---- | 5,068   |
| Accrued interest payable | 456     | 3       | 453     | ---- | 456     |

## Fair Value Measurements at December 31, 2014

Using:

|                               | Carrying Value | Level 1  | Level 2 | Level 3 | Total    |
|-------------------------------|----------------|----------|---------|---------|----------|
| <b>Financial Assets:</b>      |                |          |         |         |          |
| Cash and cash equivalents     | \$30,977       | \$30,977 | \$----  | \$----  | \$30,977 |
| Certificates of deposit       |                |          |         |         |          |
| in financial institutions     | 980            | ----     | 980     | ----    | 980      |
| Securities available for sale | 85,236         | ----     | 85,236  | ----    | 85,236   |
| Securities held to maturity   | 22,820         | ----     | 12,144  | 11,426  | 23,570   |
| Federal Home Loan Bank and    |                |          |         |         |          |
| Federal Reserve Bank stock    | 6,576          | N/A      | N/A     | N/A     | N/A      |
| Loans, net                    | 586,434        | ----     | ----    | 591,594 | 591,594  |
| Accrued interest receivable   | 1,806          | ----     | 230     | 1,576   | 1,806    |
| <b>Financial liabilities:</b> |                |          |         |         |          |
| Deposits                      | 646,830        | 161,784  | 485,503 | ----    | 647,287  |
| Other borrowed funds          | 24,972         | ----     | 24,555  | ----    | 24,555   |
| Subordinated debentures       | 8,500          | ----     | 4,979   | ----    | 4,979    |
| Accrued interest payable      | 394            | 4        | 390     | ----    | 394      |

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

**Cash and Cash Equivalents:** The carrying amounts of cash and short-term instruments approximate fair values and are classified as Level 1.

**Certificates of Deposit in Financial Institutions:** The carrying amounts of certificates of deposit in financial institutions approximate fair values and are classified as Level 2.

**Securities Held to Maturity:** The fair values for securities held to maturity are determined in the same manner as securities held for sale and discussed earlier in this note. Level 3 securities consist of nonrated municipal bonds and tax credit ("QZAB") bonds.

**Federal Home Loan Bank and Federal Reserve Bank stock:** It is not practical to determine the fair value of both Federal Home Loan Bank and Federal Reserve Bank stock due to restrictions placed on its transferability.

**Loans:** Fair values of loans are estimated as follows: The fair value of fixed rate loans is estimated by discounting future cash flows using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. 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. 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.

**Deposit Liabilities:** The fair values disclosed for noninterest-bearing 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. The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date resulting in a Level 2 classification. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flows 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.

**Other Borrowed Funds:** The carrying values of the Company's short-term borrowings, generally maturing within ninety days, approximate their fair values, resulting in a Level 2 classification. The fair values of the Company's long-term 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 values of the Company's Subordinated Debentures 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.

Accrued Interest Receivable and Payable: The carrying amount of accrued interest approximates fair value, resulting in a classification that is consistent with the earning assets and interest-bearing liabilities with which it is associated.

Off-balance Sheet Instruments: Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments is not material.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

### NOTE 3 – SECURITIES

The following table summarizes the amortized cost and estimated fair value of the available for sale and held to maturity securities portfolios at June 30, 2015 and December 31, 2014 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income for available for sale securities and gross unrecognized gains and losses for held to maturity securities:

|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair Value |
|--|-------------------|------------------------------|-------------------------------|-------------------------|
| <b>Securities Available for Sale</b>             |                   |                              |                               |                         |
| <b>June 30, 2015</b>                             |                   |                              |                               |                         |
| U.S. Government sponsored entity securities      | \$9,015           | \$3                          | \$(32 )                       | \$8,986                 |
| Agency mortgage-backed securities, residential   | 75,144            | 1,342                        | (509 )                        | 75,977                  |
| Total securities                                 | \$84,159          | \$1,345                      | \$(541 )                      | \$84,963                |
| <b>December 31, 2014</b>                         |                   |                              |                               |                         |
| U.S. Government sponsored entity securities      | \$9,019           | \$2                          | \$(104 )                      | \$8,917                 |
| Agency mortgage-backed securities, residential   | 74,762            | 1,693                        | (136 )                        | 76,319                  |
| Total securities                                 | \$83,781          | \$1,695                      | \$(240 )                      | \$85,236                |
| <b>Securities Held to Maturity</b>               |                   |                              |                               |                         |
| <b>June 30, 2015</b>                             |                   |                              |                               |                         |
| Obligations of states and political subdivisions | \$21,906          | \$ 798                       | \$ (174 )                     | \$22,530                |
| Agency mortgage-backed securities, residential   | 8                 | ----                         | ----                          | 8                       |
| Total securities                                 | \$21,914          | \$ 798                       | \$ (174 )                     | \$22,538                |
| <b>December 31, 2014</b>                         |                   |                              |                               |                         |
| Obligations of states and political subdivisions | \$22,811          | \$ 939                       | \$ (189 )                     | \$23,561                |
| Agency mortgage-backed securities, residential   | 9                 | ----                         | ----                          | 9                       |
| Total securities                                 | \$22,820          | \$ 939                       | \$ (189 )                     | \$23,570                |



The amortized cost and estimated fair value of the securities portfolio at June 30, 2015, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because certain issuers may have the right to call or prepay the debt obligations prior to their contractual maturities. Securities not due at a single maturity are shown separately.

| Debt Securities:                               | Available for Sale |                      | Held to Maturity |                      |
|--|--------------------|----------------------|------------------|----------------------|
|  | Amortized Cost     | Estimated Fair Value | Amortized Cost   | Estimated Fair Value |
| Due in one year or less                        | \$1,002            | \$1,005              | \$410            | \$422                |
| Due in over one to five years                  | 8,013              | 7,981                | 6,417            | 6,754                |
| Due in over five to ten years                  | ----               | ----                 | 11,724           | 12,108               |
| Due after ten years                            | ----               | ----                 | 3,355            | 3,246                |
| Agency mortgage-backed securities, residential | 75,144             | 75,977               | 8                | 8                    |
| Total debt securities                          | \$84,159           | \$84,963             | \$21,914         | \$22,538             |

The following table summarizes the investment securities with unrealized losses at June 30, 2015 and December 31, 2014 by aggregated major security type and length of time in a continuous unrealized loss position:

|                               | Less Than 12 Months |                 | 12 Months or More |                 | Total      |                 |
|-------------------------------|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
|                               | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| June 30, 2015                 |                     |                 |                   |                 |            |                 |
| Securities Available for Sale |                     |                 |                   |                 |            |                 |
| U.S. Government sponsored     |                     |                 |                   |                 |            |                 |
| entity securities             | \$3,991             | \$(13 )         | \$3,989           | \$(19 )         | \$7,980    | \$ (32 )        |
| Agency mortgage-backed        |                     |                 |                   |                 |            |                 |
| securities, residential       | 27,837              | (406 )          | 3,869             | (103 )          | 31,706     | (509 )          |
| Total available for sale      | \$31,828            | \$(419 )        | \$7,858           | \$(122 )        | \$39,686   | \$ (541 )       |

|                             | Less Than 12 Months |                   | 12 Months or More |                   | Total      |                   |
|-----------------------------|---------------------|-------------------|-------------------|-------------------|------------|-------------------|
|                             | Fair Value          | Unrecognized Loss | Fair Value        | Unrecognized Loss | Fair Value | Unrecognized Loss |
| December 31, 2014           |                     |                   |                   |                   |            |                   |
| Securities Held to Maturity |                     |                   |                   |                   |            |                   |
| Obligations of states and   |                     |                   |                   |                   |            |                   |
| political subdivisions      | \$2,488             | \$ (29 )          | \$1,510           | \$ (145 )         | \$3,998    | \$ (174 )         |
| Total held to maturity      | \$2,488             | \$ (29 )          | \$1,510           | \$ (145 )         | \$3,998    | \$ (174 )         |

|                               | Less Than 12 Months |                 | 12 Months or More |                 | Total      |                 |
|-------------------------------|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
|                               | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| December 31, 2014             |                     |                 |                   |                 |            |                 |
| Securities Available for Sale |                     |                 |                   |                 |            |                 |
| U.S. Government sponsored     |                     |                 |                   |                 |            |                 |
| entity securities             | \$----              | \$----          | \$7,911           | \$(104 )        | \$7,911    | \$ (104 )       |
| Agency mortgage-backed        |                     |                 |                   |                 |            |                 |



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|                          |          |          |          |           |          |           |
|--------------------------|----------|----------|----------|-----------|----------|-----------|
| securities, residential  | 11,232   | (20 )    | 8,397    | (116 )    | 19,629   | (136 )    |
| Total available for sale | \$11,232 | \$ (20 ) | \$16,308 | \$ (220 ) | \$27,540 | \$ (240 ) |

|                             | Less Than 12 Months |                   | 12 Months or More |                   | Total      |                   |
|-----------------------------|---------------------|-------------------|-------------------|-------------------|------------|-------------------|
|                             | Fair Value          | Unrecognized Loss | Fair Value        | Unrecognized Loss | Fair Value | Unrecognized Loss |
| Securities Held to Maturity |                     |                   |                   |                   |            |                   |
| Obligations of states and   |                     |                   |                   |                   |            |                   |
| political subdivisions      | \$1,171             | \$ (9 )           | \$2,916           | \$ (180 )         | \$4,087    | \$ (189 )         |
| Total held to maturity      | \$1,171             | \$ (9 )           | \$2,919           | \$ (180 )         | \$4,087    | \$ (189 )         |

During the three and six months ended June 30, 2015 the Company had proceeds of \$8,792 pertaining to securities sales on available for sale securities with gross gains recognized of \$135 for both periods. There were no sales during the three and six months ended June 30, 2014. Unrealized losses on the Company's debt securities have not been recognized into income because the issuers' securities are of high credit quality at June 30, 2015, and management does not intend to sell and it is likely that management will not be required to sell the securities prior to their anticipated recovery. Management does not believe any individual unrealized loss at June 30, 2015 and December 31, 2014 represents an other-than-temporary impairment.

## NOTE 4 – LOANS AND ALLOWANCE FOR LOAN LOSSES

| Loans are comprised of the following: | June 30,<br>2015 | December<br>31,<br>2014 |
|---------------------------------------|------------------|-------------------------|
| Residential real estate               | \$224,923        | \$223,628               |
| Commercial real estate:               |                  |                         |
| Owner-occupied                        | 76,081           | 78,848                  |
| Nonowner-occupied                     | 73,296           | 71,229                  |
| Construction                          | 24,645           | 27,535                  |
| Commercial and industrial             | 85,573           | 83,998                  |
| Consumer:                             |                  |                         |
| Automobile                            | 43,757           | 42,849                  |
| Home equity                           | 20,138           | 18,291                  |
| Other                                 | 44,486           | 48,390                  |
|                                       | 592,899          | 594,768                 |
| Less: Allowance for loan losses       | 7,444            | 8,334                   |
| Loans, net                            | \$585,455        | \$586,434               |

The following table presents the activity in the allowance for loan losses by portfolio segment for the three months ended June 30, 2015 and 2014:

| June 30, 2015                  | Residential<br>Real Estate | Commercial<br>Real Estate | Commercial<br>and<br>Industrial | Consumer | Total    |
|--------------------------------|----------------------------|---------------------------|---------------------------------|----------|----------|
| Allowance for loan losses:     |                            |                           |                                 |          |          |
| Beginning balance              | \$1,465                    | \$4,210                   | \$1,738                         | \$907    | \$8,320  |
| Provision for loan losses      | (121 )                     | (64 )                     | 478                             | 506      | 799      |
| Loans charged off              | (126 )                     | (1,366 )                  | (22 )                           | (446 )   | (1,960 ) |
| Recoveries                     | 12                         | 15                        | 93                              | 165      | 285      |
| Total ending allowance balance | \$1,230                    | \$2,795                   | \$2,287                         | \$1,132  | \$7,444  |

| June 30, 2014                  | Residential<br>Real Estate | Commercial<br>Real Estate | Commercial<br>and<br>Industrial | Consumer | Total   |
|--------------------------------|----------------------------|---------------------------|---------------------------------|----------|---------|
| Allowance for loan losses:     |                            |                           |                                 |          |         |
| Beginning balance              | \$1,437                    | \$2,845                   | \$1,331                         | \$849    | \$6,462 |
| Provision for loan losses      | 444                        | 383                       | 201                             | 358      | 1,386   |
| Loans charged off              | (139 )                     | ----                      | (4 )                            | (197 )   | (340 )  |
| Recoveries                     | 136                        | 48                        | 97                              | 139      | 420     |
| Total ending allowance balance | \$1,878                    | \$3,276                   | \$1,625                         | \$1,149  | \$7,928 |

The following table presents the activity in the allowance for loan losses by portfolio segment for the six months ended June 30, 2015 and 2014:

| June 30, 2015 | Residential<br>Real Estate | Commercial<br>Real Estate | Commercial | Consumer | Total |
|---------------|----------------------------|---------------------------|------------|----------|-------|
|---------------|----------------------------|---------------------------|------------|----------|-------|

and  
Industrial

## Allowance for loan losses:

|                                |         |          |         |         |          |
|--------------------------------|---------|----------|---------|---------|----------|
| Beginning balance              | \$1,426 | \$4,195  | \$1,602 | \$1,111 | \$8,334  |
| Provision for loan losses      | (90 )   | (58 )    | 492     | 377     | 721      |
| Loans charged off              | (223 )  | (1,374 ) | (24 )   | (707 )  | (2,328 ) |
| Recoveries                     | 117     | 32       | 217     | 351     | 717      |
| Total ending allowance balance | \$1,230 | \$2,795  | \$2,287 | \$1,132 | \$7,444  |

| June 30, 2014                  | Residential<br>Real Estate | Commercial<br>Real Estate | Commercial<br>and<br>Industrial | Consumer | Total   |
|--------------------------------|----------------------------|---------------------------|---------------------------------|----------|---------|
| Allowance for loan losses:     |                            |                           |                                 |          |         |
| Beginning balance              | \$1,169                    | \$2,914                   | \$1,279                         | \$793    | \$6,155 |
| Provision for loan losses      | 753                        | 440                       | 182                             | 505      | 1,880   |
| Loans charged off              | (193 )                     | (157 )                    | (4 )                            | (452 )   | (806 )  |
| Recoveries                     | 149                        | 79                        | 168                             | 303      | 699     |
| Total ending allowance balance | \$1,878                    | \$3,276                   | \$1,625                         | \$1,149  | \$7,928 |

The following table presents the balance in the allowance for loan losses and the recorded investment of loans by portfolio segment and based on impairment method as of June 30, 2015 and December 31, 2014:

|   | Residential<br>Real Estate | Commercial<br>Real Estate | Commercial<br>and<br>Industrial | Consumer   | Total      |
|---|----------------------------|---------------------------|---------------------------------|------------|------------|
| June 30, 2015                                   |                            |                           |                                 |            |            |
| Allowance for loan losses:                      |                            |                           |                                 |            |            |
| Ending allowance balance attributable to loans: |                            |                           |                                 |            |            |
| Individually evaluated for impairment           | \$----                     | \$ 1,168                  | \$ 1,522                        | \$4        | \$2,694    |
| Collectively evaluated for impairment           | 1,230                      | 1,627                     | 765                             | 1,128      | 4,750      |
| Total ending allowance balance                  | \$ 1,230                   | \$ 2,795                  | \$ 2,287                        | \$ 1,132   | \$ 7,444   |
| Loans:  |                            |                           |                                 |            |            |
| Loans individually evaluated for impairment     | \$ 1,902                   | \$ 10,275                 | \$ 7,510                        | \$ 218     | \$ 19,905  |
| Loans collectively evaluated for impairment     | 223,021                    | 163,747                   | 78,063                          | 108,163    | 572,994    |
| Total ending loans balance                      | \$ 224,923                 | \$ 174,022                | \$ 85,573                       | \$ 108,381 | \$ 592,899 |
| December 31, 2014                               |                            |                           |                                 |            |            |
| Allowance for loan losses:                      |                            |                           |                                 |            |            |
| Ending allowance balance attributable to loans: |                            |                           |                                 |            |            |
| Individually evaluated for impairment           | \$----                     | \$ 2,506                  | \$ 900                          | \$6        | \$3,412    |
| Collectively evaluated for impairment           | 1,426                      | 1,689                     | 702                             | 1,105      | 4,922      |
| Total ending allowance balance                  | \$ 1,426                   | \$ 4,195                  | \$ 1,602                        | \$ 1,111   | \$ 8,334   |
| Loans:  |                            |                           |                                 |            |            |
| Loans individually evaluated for impairment     | \$ 1,415                   | \$ 11,711                 | \$ 6,824                        | \$ 219     | \$ 20,169  |
| Loans collectively evaluated for impairment     | 222,213                    | 165,901                   | 77,174                          | 109,311    | 574,599    |
| Total ending loans balance                      | \$ 223,628                 | \$ 177,612                | \$ 83,998                       | \$ 109,530 | \$ 594,768 |

The following tables present information related to loans individually evaluated for impairment by class of loans as of June 30, 2015 and December 31, 2014:

|                             | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Allowance<br>for Loan<br>Losses<br>Allocated |
|-----------------------------|--------------------------------|------------------------|--|
| June 30, 2015               |                                |                        |  |
| With an allowance recorded: |                                |                        |  |
| Commercial real estate:     |                                |                        |  |
| Owner-occupied              | \$478                          | \$478                  | \$437  |
| Nonowner-occupied           | 3,558                          | 3,558                  | 731  |
| Commercial and industrial   | 3,325                          | 3,325                  | 1,522  |

|                                     |          |          |         |
|-------------------------------------|----------|----------|---------|
| Consumer:                           |          |          |         |
| Home equity                         | 218      | 218      | 4       |
| With no related allowance recorded: |          |          |         |
| Residential real estate             | 1,902    | 1,902    | ----    |
| Commercial real estate:             |          |          |         |
| Owner-occupied                      | 3,133    | 2,587    | ----    |
| Nonowner-occupied                   | 4,667    | 2,972    | ----    |
| Construction                        | 680      | 680      | ----    |
| Commercial and industrial           | 4,219    | 4,185    | ----    |
| Total                               | \$22,180 | \$19,905 | \$2,694 |

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| December 31, 2014                   | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Allowance<br>for Loan<br>Losses<br>Allocated |
|-------------------------------------|--------------------------------|------------------------|--|
| With an allowance recorded:         |                                |                        |  |
| Commercial real estate:             |                                |                        |  |
| Owner-occupied                      | \$1,177                        | \$1,177                | \$414  |
| Nonowner-occupied                   | 7,656                          | 7,656                  | 2,092  |
| Commercial and industrial           | 2,356                          | 2,356                  | 900  |
| Consumer:                           |                                |                        |  |
| Home equity                         | 219                            | 219                    | 6  |
| With no related allowance recorded: |                                |                        |  |
| Residential real estate             | 1,415                          | 1,415                  | ----   |
| Commercial real estate:             |                                |                        |  |
| Owner-occupied                      | 3,125                          | 2,578                  | ----   |
| Nonowner-occupied                   | 1,298                          | 300                    | ----   |
| Commercial and industrial           | 4,703                          | 4,468                  | ----   |
| Total                               | \$21,949                       | \$20,169               | \$3,412                                      |

The following tables present information related to loans individually evaluated for impairment by class of loans for the three and six months ended June 30, 2015 and 2014:

|                                     | Three months ended June 30, 2015 |                                  |   | Six months ended June 30, 2015 |                                  |   |
|-------------------------------------|----------------------------------|----------------------------------|---|--------------------------------|----------------------------------|---|
|                                     | Average<br>Impaired<br>Loans     | Interest<br>Income<br>Recognized | Cash<br>Basis<br>Interest<br>Recognized | Average<br>Impaired<br>Loans   | Interest<br>Income<br>Recognized | Cash<br>Basis<br>Interest<br>Recognized |
| With an allowance recorded:         |                                  |                                  |   |                                |                                  |   |
| Commercial real estate:             |                                  |                                  |   |                                |                                  |   |
| Owner-occupied                      | \$ 478                           | \$ ----                          | \$ ----                                 | \$ 711                         | \$ ----                          | \$ ----                                 |
| Nonowner-occupied                   | 3,575                            | 49                               | 49                                      | 3,598                          | 65                               | 65                                      |
| Commercial and industrial           | 3,185                            | 40                               | 40                                      | 2,909                          | 65                               | 65                                      |
| Consumer:                           |                                  |                                  |   |                                |                                  |   |
| Home equity                         | 218                              | 2                                | 2                                       | 219                            | 4                                | 4                                       |
| With no related allowance recorded: |                                  |                                  |   |                                |                                  |   |
| Residential real estate             | 1,656                            | 16                               | 16                                      | 1,575                          | 25                               | 25                                      |
| Commercial real estate:             |                                  |                                  |   |                                |                                  |   |
| Owner-occupied                      | 2,570                            | 30                               | 30                                      | 2,573                          | 60                               | 60                                      |
| Nonowner-occupied                   | 3,630                            | 13                               | 13                                      | 3,857                          | 25                               | 25                                      |
| Construction                        | 680                              | ----                             | ----                                    | 453                            | ----                             | ----                                    |
| Commercial and industrial           | 4,249                            | 51                               | 51                                      | 4,322                          | 107                              | 107                                     |
| Total                               | \$ 20,241                        | \$ 201                           | \$ 201                                  | \$ 20,217                      | \$ 351                           | \$ 351                                  |

|  | Three months ended June 30, 2014 |                    |               | Six months ended June 30, 2014 |                    |               |
|--|----------------------------------|--------------------|---------------|--------------------------------|--------------------|---------------|
|  | Average<br>Impaired              | Interest<br>Income | Cash<br>Basis |                                | Interest<br>Income | Cash<br>Basis |

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|                                     | Loans     | Recognized | Interest<br>Recognized | Average<br>Impaired<br>Loans | Recognized | Interest<br>Recognized |
|-------------------------------------|-----------|------------|------------------------|------------------------------|------------|------------------------|
| With an allowance recorded:         |           |            |                        |                              |            |                        |
| Residential real estate             | \$ 898    | \$ 8       | \$ 8                   | \$ 902                       | \$ 17      | \$ 17                  |
| Commercial real estate:             |           |            |                        |                              |            |                        |
| Nonowner-occupied                   | 3,317     | 40         | 40                     | 3,330                        | 74         | 74                     |
| Commercial and industrial           | 2,441     | 28         | 28                     | 2,514                        | 57         | 57                     |
| Consumer:                           |           |            |                        |                              |            |                        |
| Home equity                         | 219       | 2          | 2                      | 219                          | 4          | 4                      |
| With no related allowance recorded: |           |            |                        |                              |            |                        |
| Residential real estate             | 525       | 6          | 6                      | 526                          | 14         | 14                     |
| Commercial real estate:             |           |            |                        |                              |            |                        |
| Owner-occupied                      | 1,387     | 21         | 21                     | 1,255                        | 30         | 30                     |
| Nonowner-occupied                   | 5,665     | 76         | 76                     | 5,691                        | 151        | 151                    |
| Commercial and industrial           | 1,811     | 79         | 79                     | 1,207                        | 79         | 79                     |
| Total                               | \$ 16,263 | \$ 260     | \$ 260                 | \$ 15,644                    | \$ 426     | \$ 426                 |

The recorded investment of a loan is its carrying value excluding accrued interest and deferred loan fees.

Nonaccrual loans and loans past due 90 days or more and still accruing include both smaller balance homogenous loans that are collectively evaluated for impairment and individually classified as impaired loans.

The following table presents the recorded investment of nonaccrual loans and loans past due 90 days or more and still accruing by class of loans as of June 30, 2015 and December 31, 2014:

| June 30, 2015             | Loans Past<br>Due<br>90 Days<br>And<br>Still<br>Accruing | Nonaccrual |
|---------------------------|--|------------|
| Residential real estate   | \$325  | \$3,277    |
| Commercial real estate:   |  |            |
| Owner-occupied            | ----   | 715        |
| Nonowner-occupied         | ----   | 2,672      |
| Construction              | ----   | 769        |
| Commercial and industrial | ----   | 724        |
| Consumer:                 |  |            |
| Automobile                | 10   | 6          |
| Home equity               | ----   | 84         |
| Other                     | 5  | 1          |
| Total                     | \$340  | \$8,248    |

| December 31, 2014         | Loans Past<br>Due<br>90 Days<br>And<br>Still<br>Accruing | Nonaccrual |
|---------------------------|--|------------|
| Residential real estate   | \$----   | \$3,768    |
| Commercial real estate:   |  |            |
| Owner-occupied            | ----   | 1,484      |
| Nonowner-occupied         | ----   | 4,013      |
| Commercial and industrial | ----   | 95         |
| Consumer:                 |  |            |
| Automobile                | 15   | 18         |
| Home equity               | ----   | 103        |
| Other                     | 58   | 68         |
| Total                     | \$73   | \$9,549    |

The Company transfers loans to other real estate owned, at fair value less cost to sell, in the period the Company obtains physical possession of the property (through legal title or through a deed in lieu). As of June 30, 2015 and December 31, 2014, other real estate owned secured by residential real estate totaled \$350 and \$368, respectively. In addition, nonaccrual residential mortgage loans that are in the process of foreclosure had a recorded investment of



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\$2,010 and \$1,692 as of June 30, 2015 and December 31, 2014, respectively.

The following table presents the aging of the recorded investment of past due loans by class of loans as of June 30, 2015 and December 31, 2014:

| June 30, 2015             | 30-59<br>Days<br>Past Due | 60-89<br>Days<br>Past Due | 90 Days<br>Or More<br>Past Due | Total<br>Past Due | Loans Not<br>Past Due | Total     |
|---------------------------|---------------------------|---------------------------|--------------------------------|-------------------|-----------------------|-----------|
| Residential real estate   | \$2,115                   | \$579                     | \$3,402                        | \$6,096           | \$218,827             | \$224,923 |
| Commercial real estate:   |                           |                           |                                |                   |                       |           |
| Owner-occupied            | 105                       | 159                       | 715                            | 979               | 75,102                | 76,081    |
| Nonowner-occupied         | ----                      | 269                       | 2,672                          | 2,941             | 70,355                | 73,296    |
| Construction              | 111                       | ----                      | 769                            | 880               | 23,765                | 24,645    |
| Commercial and industrial | 403                       | 516                       | 91                             | 1,010             | 84,563                | 85,573    |
| Consumer:                 |                           |                           |                                |                   |                       |           |
| Automobile                | 523                       | 159                       | 16                             | 698               | 43,059                | 43,757    |
| Home equity               | 68                        | ----                      | 62                             | 130               | 20,008                | 20,138    |
| Other                     | 491                       | 46                        | 6                              | 543               | 43,943                | 44,486    |
| Total                     | \$3,816                   | \$1,728                   | \$7,733                        | \$13,277          | \$579,622             | \$592,899 |

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| December 31, 2014         | 30-59<br>Days<br>Past Due | 60-89<br>Days<br>Past Due | 90 Days<br>Or More<br>Past Due | Total<br>Past Due | Loans Not<br>Past Due | Total     |
|---------------------------|---------------------------|---------------------------|--------------------------------|-------------------|-----------------------|-----------|
| Residential real estate   | \$3,337                   | \$612                     | \$3,489                        | \$7,438           | \$216,190             | \$223,628 |
| Commercial real estate:   |                           |                           |                                |                   |                       |           |
| Owner-occupied            | 74                        | 62                        | 1,422                          | 1,558             | 77,290                | 78,848    |
| Nonowner-occupied         | ----                      | ----                      | ----                           | ----              | 71,229                | 71,229    |
| Construction              | 932                       | ----                      | ----                           | 932               | 26,603                | 27,535    |
| Commercial and industrial | ----                      | 10                        | 24                             | 34                | 83,964                | 83,998    |
| Consumer:                 |                           |                           |                                |                   |                       |           |
| Automobile                | 616                       | 149                       | 33                             | 798               | 42,051                | 42,849    |
| Home equity               | ----                      | ----                      | 103                            | 103               | 18,188                | 18,291    |
| Other                     | 655                       | 20                        | 126                            | 801               | 47,589                | 48,390    |
| Total                     | \$5,614                   | \$853                     | \$5,197                        | \$11,664          | \$583,104             | \$594,768 |

Troubled Debt Restructurings:

A troubled debt restructuring (“TDR”) occurs when the Company has agreed to a loan modification in the form of a concession for a borrower who is experiencing financial difficulty. All TDR's are considered to be impaired. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; a reduction in the contractual principal and interest payments of the loan; or short-term interest-only payment terms.

The Company has allocated reserves for a portion of its TDR's to reflect the fair values of the underlying collateral or the present value of the concessionary terms granted to the customer.

The following table presents the types of TDR loan modifications by class of loans as of June 30, 2015 and December 31, 2014:

|  | TDR's<br>Performing<br>to Modified<br>Terms | TDR's Not<br>Performing<br>to Modified<br>Terms | Total<br>TDR's |
|--|---|---|----------------|
| June 30, 2015  |   |   |                |
| Residential real estate                                  |   |   |                |
| Interest only payments                                   | \$1,007                                     | \$----  | \$1,007        |
| Commercial real estate:                                  |   |   |                |
| Owner-occupied   |   |   |                |
| Interest only payments                                   | 517   | ----  | 517            |
| Rate reduction   | ----  | 236   | 236            |
| Reduction of principal and interest payments             | 616   | ----  | 616            |
| Maturity extension at lower stated rate than market rate | 1,014                                       | ----  | 1,014          |
| Credit extension at lower stated rate than market rate   | 204   | ----  | 204            |
| Nonowner-occupied  |   |   |                |
| Interest only payments                                   | 3,456                                       | 2,672   | 6,128          |
| Rate reduction   | 402   | ----  | 402            |
| Commercial and industrial                                |   |   |                |

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|  |          |         |          |
|--|----------|---------|----------|
| Interest only payments                                   | 6,622    | ----    | 6,622    |
| Credit extension at lower stated rate than market rate   | 393      | ----    | 393      |
| Consumer:  |          |         |          |
| Home equity  |          |         |          |
| Maturity extension at lower stated rate than market rate | 218      | ----    | 218      |
| Total TDR's  | \$14,449 | \$2,908 | \$17,357 |

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|  | TDR's<br>Performing<br>to Modified<br>Terms | TDR's Not<br>Performing<br>to Modified<br>Terms | Total<br>TDR's |
|--|---|---|----------------|
| December 31, 2014  |   |   |                |
| Residential real estate                                  |   |   |                |
| Interest only payments                                   | \$520                                       | \$----  | \$520          |
| Commercial real estate:                                  |   |   |                |
| Owner-occupied   |   |   |                |
| Interest only payments                                   | 457   | ----  | 457            |
| Rate reduction   | ----  | 244   | 244            |
| Reduction of principal and interest payments             | 627   | ----  | 627            |
| Maturity extension at lower stated rate than market rate | 1,046                                       | ----  | 1,046          |
| Credit extension at lower stated rate than market rate   | 204   | ----  | 204            |
| Nonowner-occupied  |   |   |                |
| Interest only payments                                   | 3,535                                       | 4,013   | 7,548          |
| Rate reduction   | 408   | ----  | 408            |
| Commercial and industrial                                |   |   |                |
| Interest only payments                                   | 6,429                                       | ----  | 6,429          |
| Credit extension at lower stated rate than market rate   | 395   | ----  | 395            |
| Consumer:  |   |   |                |
| Home equity  |   |   |                |
| Maturity extension at lower stated rate than market rate | 219   | ----  | 219            |
| Total TDR's  | \$13,840                                    | \$4,257   | \$18,097       |

During the six months ended June 30, 2015, the TDR's described above increased the allowance for loan losses and provision expense by \$68 with a corresponding charge-off of \$1,304. This is compared to a \$194 decrease in the provision expense and the allowance for loan losses during the six months ended June 30, 2014 with no corresponding charge-offs. The charge-off of \$1,304 during 2015 was related to specific reserves that had already been provided for during 2014, and, as a result, did not impact provision expense during 2015. During the year ended December 31, 2014, the TDR's described above increased the allowance for loan losses and provision expense by \$623 with no corresponding charge-offs.

At June 30, 2015, the balance in TDR loans decreased \$740, or 4.1%, from year-end 2014. The decrease was largely due to a \$1,304 charge-off of an existing specific allocation on a collateral-dependent commercial real estate loan. The effect from this specific allocation charge-off was partially offset by a \$495 residential real estate loan classified as a TDR during the second quarter of 2015. The Company had 83% of its TDR's performing according to their modified terms at June 30, 2015, as compared to 77% at December 31, 2014. TDR loans not performing to modified terms were largely impacted by a commercial real estate loan totaling \$4,013 that was converted to nonaccrual status during the fourth quarter of 2014 after it was determined that full loan repayment was in significant doubt. A further review of the collateral values of this commercial real estate loan during the fourth quarter of 2014 identified additional impairment, resulting in a specific allocation of \$1,340 at December 31, 2014. During the second quarter of 2015, the specific allocation related to this impaired loan was charged off, as previously mentioned. As a result, the Company's specific allocations in reserves to customers whose loan terms have been modified in TDR's totaled \$1,762 at June 30, 2015, as compared to \$2,998 in reserves at December 31, 2014. At June 30, 2015, the Company had \$1,678 in commitments to lend additional amounts to customers with outstanding loans that are classified as TDR's, as compared to \$1,871 at December 31, 2014.



The following table presents the pre- and post-modification balances of TDR loan modifications by class of loans that occurred during the six months ended June 30, 2015 and 2014:

|                                | TDR's<br>Performing to Modified<br>Terms   |   | TDR's Not<br>Performing to Modified<br>Terms |   |
|--------------------------------|--|---|--|---|
|                                | Pre-Modification<br>Recorded<br>Investment | Post-Modification<br>Recorded<br>Investment | Pre-Modification<br>Recorded<br>Investment   | Post-Modification<br>Recorded<br>Investment |
| Six months ended June 30, 2015 |  |   |  |   |

Residential real estate:

|                        |       |        |        |         |
|------------------------|-------|--------|--------|---------|
| Interest only payments | \$495 | \$ 495 | \$---- | \$ ---- |
| Total TDR's            | \$495 | \$ 495 | \$---- | \$ ---- |

|                                | TDR's<br>Performing to Modified<br>Terms   |   | TDR's Not<br>Performing to Modified<br>Terms |   |
|--------------------------------|--|---|--|---|
|                                | Pre-Modification<br>Recorded<br>Investment | Post-Modification<br>Recorded<br>Investment | Pre-Modification<br>Recorded<br>Investment   | Post-Modification<br>Recorded<br>Investment |
| Six months ended June 30, 2014 |  |   |  |   |

Commercial real estate:

|  |         |          |        |         |
|--|---------|----------|--------|---------|
| Owner-occupied   |         |          |        |         |
| Maturity extension at lower stated rate than market rate | \$767   | \$ 767   | \$---- | \$ ---- |
| Commercial and industrial                                |         |          |        |         |
| Interest only payments                                   | 3,621   | 3,621    | ----   | ----    |
| Total TDR's  | \$4,388 | \$ 4,388 | \$---- | \$ ---- |

All of the Company's loans that were restructured during the six months ended June 30, 2015 and 2014 were performing in accordance with their modified terms. Furthermore, there were no TDR's described above at June 30, 2015 and 2014 that experienced any payment defaults within twelve months following their loan modification. A default is considered to have occurred once the TDR is past due 90 days or more or it has been placed on nonaccrual. TDR loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. The loans modified during the six months ended June 30, 2015 had no impact on the provision expense or the allowance for loan losses. As of June 30, 2015, the Company had no allocation of reserves to customers whose loan terms were modified during the first six months of 2015. The loans modified during the six months ended June 30, 2014 had no impact on the provision expense or the allowance for loan losses. As of June 30, 2014, the Company had no allocation of reserves to customers whose loan terms were modified during the first six months of 2014.

Credit Quality Indicators:

The Company categorizes 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. These risk categories are represented by a loan grading scale from 1 through 10. The Company analyzes loans individually with a higher credit risk rating and groups these loans into categories called "criticized" and "classified" assets. The Company considers its criticized assets to be loans that are graded 8 and its classified assets to be loans that are graded 9 or 10. The Company's risk categories are

reviewed at least annually on loans that have aggregate borrowing amounts that meet or exceed \$500.

The Company uses the following definitions for its criticized loan risk ratings:

Special Mention (Loan Grade 8). Loans classified as special mention indicate considerable risk due to deterioration of repayment (in the earliest stages) due to potential weak primary repayment source, or payment delinquency. These loans will be under constant supervision, are not classified and do not expose the institution to sufficient risks to warrant classification. These deficiencies should be correctable within the normal course of business, although significant changes in company structure or policy may be necessary to correct the deficiencies. These loans are considered bankable assets with no apparent loss of principal or interest envisioned. The perceived risk in continued lending is considered to have increased beyond the level where such loans would normally be granted. Credits that are defined as a troubled debt restructuring should be graded no higher than special mention until they have been reported as performing over one year after restructuring.

The Company uses the following definitions for its classified loan risk ratings:

**Substandard (Loan Grade 9).** Loans classified as substandard represent very high risk, serious delinquency, nonaccrual, or unacceptable credit. Repayment through the primary source of repayment is in jeopardy due to the existence of one or more well defined weaknesses, and the collateral pledged may inadequately protect collection of the loans. Loss of principal is not likely if weaknesses are corrected, although financial statements normally reveal significant weakness. Loans are still considered collectible, although loss of principal is more likely than with special mention loan grade 8 loans. Collateral liquidation is considered likely to satisfy debt.

**Doubtful (Loan Grade 10).** Loans classified as doubtful display a high probability of loss, although the amount of actual loss at the time of classification is undetermined. This should be a temporary category until such time that actual loss can be identified, or improvements made to reduce the seriousness of the classification. These loans exhibit all substandard characteristics with the addition that weaknesses make collection or liquidation in full highly questionable and improbable. This classification consists of loans where the possibility of loss is high after collateral liquidation based upon existing facts, market conditions, and value. Loss is deferred until certain important and reasonable specific pending factors which may strengthen the credit can be more accurately determined. These factors may include proposed acquisitions, liquidation procedures, capital injection, receipt of additional collateral, mergers, or refinancing plans. A doubtful classification for an entire credit should be avoided when collection of a specific portion appears highly probable with the adequately secured portion graded substandard.

Criticized and classified loans will mostly consist of commercial and industrial and commercial real estate loans. The Company considers its loans that do not meet the criteria for a criticized and classified asset rating as pass rated loans, which will include loans graded from 1 (Prime) to 7 (Watch). All commercial loans are categorized into a risk category either at the time of origination or reevaluation date. As of June 30, 2015 and December 31, 2014, and based on the most recent analysis performed, the risk category of commercial loans by class of loans was as follows:

| June 30, 2015             | Pass      | Criticized | Classified | Total     |
|---------------------------|-----------|------------|------------|-----------|
| Commercial real estate:   |           |            |            |           |
| Owner-occupied            | \$69,108  | \$3,227    | \$3,746    | \$76,081  |
| Nonowner-occupied         | 63,993    | 2,064      | 7,239      | 73,296    |
| Construction              | 23,713    | ----       | 932        | 24,645    |
| Commercial and industrial | 76,927    | 639        | 8,007      | 85,573    |
| Total                     | \$233,741 | \$5,930    | \$19,924   | \$259,595 |

| December 31, 2014         | Pass      | Criticized | Classified | Total     |
|---------------------------|-----------|------------|------------|-----------|
| Commercial real estate:   |           |            |            |           |
| Owner-occupied            | \$72,232  | \$2,102    | \$4,514    | \$78,848  |
| Nonowner-occupied         | 60,491    | 2,127      | 8,611      | 71,229    |
| Construction              | 27,364    | ----       | 171        | 27,535    |
| Commercial and industrial | 76,395    | 495        | 7,108      | 83,998    |
| Total                     | \$236,482 | \$4,724    | \$20,404   | \$261,610 |

The Company also obtains the credit scores of its borrowers upon origination (if available by the credit bureau), but the scores are not updated. The Company focuses mostly on the performance and repayment ability of the borrower as



an indicator of credit risk and does not consider a borrower's credit score to be a significant influence in the determination of a loan's credit risk grading.

For residential and consumer loan classes, the Company 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 of residential and consumer loans by class of loans based on repayment activity as of June 30, 2015 and December 31, 2014:

| June 30, 2015 | Consumer   |                |          | Residential<br>Real Estate | Total     |
|---------------|------------|----------------|----------|----------------------------|-----------|
|               | Automobile | Home<br>Equity | Other    |                            |           |
| Performing    | \$43,741   | \$20,054       | \$44,480 | \$221,321                  | \$329,596 |
| Nonperforming | 16         | 84             | 6        | 3,602                      | 3,708     |
| Total         | \$43,757   | \$20,138       | \$44,486 | \$224,923                  | \$333,304 |

  

| December 31, 2014 | Consumer   |                |          | Residential<br>Real Estate | Total     |
|-------------------|------------|----------------|----------|----------------------------|-----------|
|                   | Automobile | Home<br>Equity | Other    |                            |           |
| Performing        | \$42,816   | \$18,188       | \$48,264 | \$219,860                  | \$329,128 |
| Nonperforming     | 33         | 103            | 126      | 3,768                      | 4,030     |
| Total             | \$42,849   | \$18,291       | \$48,390 | \$223,628                  | \$333,158 |

The Company, through its subsidiaries, originates residential, consumer, and commercial loans to customers located primarily in the southeastern areas of Ohio as well as the western counties of West Virginia. Approximately 5.70% of total loans were unsecured at June 30, 2015, up from 5.66% at December 31, 2014.

#### NOTE 5 - FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and financial guarantees. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit, and financial guarantees written, is represented by the contractual amount of those instruments. The contract amounts of these instruments are not included in the consolidated financial statements. At June 30, 2015, the contract amounts of these instruments totaled approximately \$57,558, compared to \$55,344 at December 31, 2014. The Bank uses the same credit policies in making commitments and conditional obligations as it does for instruments recorded on the balance sheet. Since many of these instruments are expected to expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements.

#### NOTE 6 - OTHER BORROWED FUNDS

Other borrowed funds at June 30, 2015 and December 31, 2014 were comprised of advances from the Federal Home Loan Bank ("FHLB") of Cincinnati and promissory notes.

|                   | FHLB<br>Borrowings | Promissory<br>Notes | Totals   |
|-------------------|--------------------|---------------------|----------|
| June 30, 2015     | \$ 20,531          | \$3,791             | \$24,322 |
| December 31, 2014 | \$ 21,181          | \$3,791             | \$24,972 |

Pursuant to collateral agreements with the FHLB, advances were secured by \$215,102 in qualifying mortgage loans, \$82,900 in commercial loans and \$5,081 in FHLB stock at June 30, 2015. Fixed-rate FHLB advances of \$20,531 mature through 2042 and have interest rates ranging from 1.34% to 3.31% and a year-to-date weighted average cost of 2.09%. There were no variable-rate FHLB borrowings at June 30, 2015.

At June 30, 2015, the Company had a cash management line of credit enabling it to borrow up to \$75,000 from the FHLB. All cash management advances have an original maturity of 90 days. The line of credit must be renewed on an annual basis. There was \$75,000 available on this line of credit at June 30, 2015. Based on the Company's current FHLB stock ownership, total assets and pledgeable loans, the Company had the ability to obtain borrowings from the FHLB up to a maximum of \$174,081 at June 30, 2015. Of this maximum borrowing capacity, the Company had \$115,749 available to use as additional borrowings, of which \$75,000 could be used for short-term, cash management advances, as mentioned above.

Promissory notes, issued primarily by Ohio Valley, have fixed rates of 1.15% to 1.50% and are due at various dates through a final maturity date of December 8, 2016. At June 30, 2015, there were no promissory notes payable by Ohio Valley to related parties.

Letters of credit issued on the Bank's behalf by the FHLB to collateralize certain public unit deposits as required by law totaled \$37,800 at June 30, 2015 and \$29,500 at December 31, 2014.

Scheduled principal payments as of June 30, 2015:

|            | FHLB<br>Borrowings | Promissory<br>Notes | Totals   |
|------------|--------------------|---------------------|----------|
| 2015       | \$ 1,123           | \$2,456             | \$3,579  |
| 2016       | 1,594              | 1,335               | 2,929    |
| 2017       | 4,534              | ----                | 4,534    |
| 2018       | 1,484              | ----                | 1,484    |
| 2019       | 1,443              | ----                | 1,443    |
| Thereafter | 10,353             | ----                | 10,353   |
|            | \$20,531           | \$3,791             | \$24,322 |

#### NOTE 7 – SEGMENT INFORMATION

The reportable segments are determined by the products and services offered, primarily distinguished between banking and consumer finance. They are also distinguished by the level of information provided to the chief operating decision maker, who uses such information to review performance of various components of the business, which are then aggregated if operating performance, products/services, and customers are similar. Loans, investments, and deposits provide the majority of the net revenues from the banking operation, while loans provide the majority of the net revenues for the consumer finance segment. All Company segments are domestic.

Total revenues from the banking segment, which accounted for the majority of the Company's total revenues, totaled 88.9% and 88.6% of total consolidated revenues for the quarters ended June 30, 2015 and 2014, respectively.

The accounting policies used for the Company's reportable segments are the same as those described in Note 1 - Summary of Significant Accounting Policies. Income taxes are allocated based on income before tax expense.

Information for the Company's reportable segments is as follows:

|         | Three Months Ended June 30, 2015 |                  |
|---------|----------------------------------|------------------|
|         | Consumer<br>Finance              | Total<br>Company |
| Banking |                                  |                  |

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|                     |         |        |         |
|---------------------|---------|--------|---------|
| Net interest income | \$7,502 | \$647  | \$8,149 |
| Provision expense   | 850     | (51 )  | 799     |
| Noninterest income  | 1,786   | 131    | 1,917   |
| Noninterest expense | 6,866   | 688    | 7,554   |
| Tax expense         | 256     | 47     | 303     |
| Net income          | 1,316   | 94     | 1,410   |
| Assets              | 787,363 | 13,010 | 800,373 |

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|                     | Three Months Ended June 30, 2014 |                  |               |
|---------------------|----------------------------------|------------------|---------------|
|                     | Banking                          | Consumer Finance | Total Company |
| Net interest income | \$7,560                          | \$627            | \$8,187       |
| Provision expense   | 1,425                            | (39 )            | 1,386         |
| Noninterest income  | 1,715                            | 197              | 1,912         |
| Noninterest expense | 6,362                            | 635              | 6,997         |
| Tax expense         | 295                              | 77               | 372           |
| Net income          | 1,193                            | 151              | 1,344         |
| Assets              | 750,387                          | 13,426           | 763,813       |

|                     | Six Months Ended June 30, 2015 |                  |               |
|---------------------|--------------------------------|------------------|---------------|
|                     | Banking                        | Consumer Finance | Total Company |
| Net interest income | \$ 15,063                      | \$2,016          | \$ 17,079     |
| Provision expense   | 675                            | 46               | 721           |
| Noninterest income  | 4,829                          | 577              | 5,406         |
| Noninterest expense | 13,573                         | 1,408            | 14,981        |
| Tax expense         | 1,363                          | 386              | 1,749         |
| Net income          | 4,281                          | 753              | 5,034         |
| Assets              | 787,363                        | 13,010           | 800,373       |

|                     | Six Months Ended June 30, 2014 |                  |               |
|---------------------|--------------------------------|------------------|---------------|
|                     | Banking                        | Consumer Finance | Total Company |
| Net interest income | \$ 14,981                      | \$ 1,988         | \$ 16,969     |
| Provision expense   | 1,800                          | 80               | 1,880         |
| Noninterest income  | 5,288                          | 742              | 6,030         |
| Noninterest expense | 12,973                         | 1,319            | 14,292        |
| Tax expense         | 1,468                          | 451              | 1,919         |
| Net income          | 4,028                          | 880              | 4,908         |
| Assets              | 750,387                        | 13,426           | 763,813       |

## ITEM 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(dollars in thousands, except share and per share data)

### Forward Looking Statements

Except for the historical statements and discussions contained herein, statements contained in this report constitute "forward looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Act of 1934 and as defined in the Private Securities Litigation Reform Act of 1995. Such statements are often, but not always, identified by the use of such words as "believes," "anticipates," "expects," and similar expressions. Such statements involve various important assumptions, risks, uncertainties, and other factors, many of

which are beyond our control that could cause actual results to differ materially from those expressed in such forward looking statements. These factors include, but are not limited to: changes in political, economic or other factors such as inflation rates, recessionary or expansive trends, taxes, the effects of legislation and the continuing economic uncertainty in various parts of the world; competitive pressures; fluctuations in interest rates; the level of defaults and prepayment on loans made by the Company; unanticipated litigation, claims, or assessments; fluctuations in the cost of obtaining funds to make loans; and regulatory changes. Additional detailed information concerning a number of important factors which could cause actual results to differ materially from the forward-looking statements contained in management's discussion and analysis is available in the Company's filings with the Securities and Exchange Commission, under the Securities Exchange Act of 1934, including the disclosure under the heading "Item 1A. Risk Factors" of Part 1 of the Company's Annual Report on Form 10- K for the fiscal year ended December 31, 2014. Readers are cautioned not to place undue reliance on such forward looking statements, which speak only as of the date hereof. The Company undertakes no obligation and disclaims any intention to republish revised or updated forward looking statements, whether as a result of new information, unanticipated future events or otherwise.

## Financial Overview

The Company is primarily engaged in commercial and retail banking, offering a blend of commercial and consumer banking services within southeastern Ohio as well as western West Virginia. The banking services offered by the Bank include the acceptance of deposits in checking, savings, time and money market accounts; the making and servicing of personal, commercial, floor plan and student loans; the making of construction and real estate loans; and credit card services. The Bank also offers individual retirement accounts, safe deposit boxes, wire transfers and other standard banking products and services. In addition, the Bank is one of a limited number of financial institutions that facilitates the payment of tax refunds through a third-party tax refund product provider. The Bank has facilitated the payment of these tax refunds through electronic refund check/deposit (“ERC/ERD”) transactions. ERC/ERD transactions involve the payment of a tax refund to the taxpayer after the Bank has received the refund from the federal/state government. ERC/ERD transactions occur primarily during the tax refund season, typically during the first quarter of each year. Loan Central also provides refund anticipation loans (“RALs”) to its customers. RALs are short-term cash advances against a customer’s anticipated income tax refund.

For the three months ended June 30, 2015, the Company’s net income increased by \$66, or 4.9%, as compared to the same period in 2014, to finish at \$1,410. Earnings per share for the second quarter of 2015 also increased by \$.01, or 3.0%, compared to the second quarter of 2014, to finish at \$.34 per share. For the six months ended June 30, 2015, net income increased by \$126, or 2.6%, as compared to the same period in 2014, to finish at \$5,034. Earnings per share for the first half of 2015 also increased by \$.02, or 1.7%, as compared to the same period in 2014, to finish at \$1.22 per share. The increase in earnings over 2014 was largely attributable to a significant savings in provision for loan loss expense that offset the negative effects of minimal to lower noninterest income and higher noninterest expense. The Company’s return on assets (“ROA”) decreased to 1.19% at June 30, 2015, compared to 1.20% at June 30, 2014. The Company’s return on equity (“ROE”) also decreased to 11.53% at June 30, 2015, compared to 12.03% at June 30, 2014.

The Company recorded net interest income of \$17,079 during the six months ended June 30, 2015, an increase of 0.6% over the six months ended June 30, 2014. The primary reasons for net interest income improvement include increasing average earning assets, a decrease in premium expense on mortgage-backed securities and declines in higher-costing time deposits. For the first half of 2015, average earning assets totaled \$807,887, which represented an increase of 4.1% over the prior year. The successful growth in average earning assets came mostly from higher interest-bearing deposits with banks, as well as growth in loans, particularly the commercial loan segment. Partially offsetting growth in average earning assets was a decline in the Company’s net interest margin, which finished at 4.24% during the second quarter of 2015 and 4.35% during the first half of 2015, as compared to 4.46% and 4.49% during the same periods in 2014, respectively. The lower net interest margin was impacted by a greater decrease in asset yields, as compared to the cost of funding sources. With the prolonged low interest rate environment, there is limited opportunity to further reduce the Company’s funding costs, while the average yield on loans continues to trend lower. As a result, the Company’s net interest income during the second quarter of 2015 decreased \$38, or 0.5%, as compared to 2014’s second quarter results.

The largest contributor to the Company’s improved net income results during each of the second quarter and year-to-date periods ended June 30, 2015 was a lower provision for loan losses. During the three and six months ended June 30, 2015, provision expense decreased \$587 and \$1,159, respectively, compared to the same periods in 2014. The higher provision expense of a year ago was primarily associated with an increase in general allocations during the first quarter of 2014 related to specific loan portfolio risks that management determined were necessary. In addition, the Company experienced a downgrade of two impaired commercial credits during the second quarter of 2014, which increased the Company’s classified assets and economic risk factor within the calculation of the allowance for loan losses. Further discussion can be found under the captions “Allowance for Loan Losses” and “Provision for Loan Losses” within this Management’s Discussion and Analysis.





Total noninterest income during the three months ended June 30, 2015 increased \$5, or 0.3%, while decreasing \$624, or 10.3%, during the six months ended June 30, 2015, as compared to the same periods in 2014. The quarterly and year-to-date periods were mostly impacted by less tax processing fees through ERC/ERD transactions. Although the volume of tax refunds processed increased in 2015, tax refund processing fees were still lower than the year before, decreasing \$159 during the second quarter of 2015, and \$712 during the first half of 2015. The decrease in total fees was due to the reduced per item fees received by the Company under the new contract with the third-party tax refund product provider, which was reported in October of 2014. Further impacting lower noninterest income was a \$135 fee received during the first quarter of 2014, which gave the buyers of ProAlliance the option to purchase the Company's pro rata shares at a future date. The option was exercised during the third quarter of 2014, resulting in a \$675 gain from the sale of ProAlliance. These decreases were partially offset by noninterest revenue growth coming from debit/credit card interchange, higher gains on sale of OREO, and gain on sale of securities.

Total noninterest expense during the three months ended June 30, 2015 increased \$557, or 8.0%, and increased \$689, or 4.8%, during the six months ended June 30, 2015, as compared to the same periods in 2014. These increases in overhead costs were largely due to increases in salaries and employee benefit expense, data processing costs, FDIC deposit premiums, and accounting fees.

At June 30, 2015, total assets were \$800,373, compared to \$778,668 at year-end 2014, with the increase due mostly to higher interest-bearing deposit balances being maintained in the Company's Federal Reserve Clearing account. Gross loan balances of \$592,899 at June 30, 2015 were just below the balances at year-end 2014, decreasing \$1,869. Total investment securities also decreased 1.1% to \$106,877 at June 30, 2015, compared to \$108,056 at year-end 2014, mostly from maturities of state and municipal security investments and continued principal repayments of mortgage-backed securities.

Total liabilities were \$711,488 at June 30, 2015, up \$19,036 since December 31, 2014. Total deposit balances experienced continued growth during 2015, increasing \$19,458 compared to year-end 2014. Noninterest-bearing deposits accounted for \$10,625 of the increase and were the result of excess deposits retained out of the seasonal increases in tax refund processing activities during the first quarter of 2015. Interest-bearing deposit growth of \$14,004 came primarily from municipal public fund and statement savings deposit balances.

At June 30, 2015, total shareholders' equity was \$88,885, up \$2,669 since December 31, 2014. Regulatory capital ratios remained significantly higher than the "well capitalized" minimums.

Comparison of  
Financial Condition  
at June 30, 2015 and December 31, 2014

The following discussion focuses, in more detail, on the consolidated financial condition of the Company at June 30, 2015 compared to December 31, 2014. This discussion should be read in conjunction with the interim consolidated financial statements and the footnotes included in this Form 10-Q.

Cash and Cash Equivalents

At June 30, 2015, cash and cash equivalents increased \$21,103, to finish at \$52,080, compared to \$30,977 at December 31, 2014. The increase in cash and cash equivalents was largely due to deposit liability growth from year-end 2014, including excess funds retained from seasonal increases in ERC/ERD transactions. The Company continues to utilize its interest-bearing Federal Reserve Bank clearing account to maintain these excess funds, which are expected to decrease during the remainder of 2015. The interest rate paid on both the required and excess reserve balances is based on the targeted federal funds rate established by the Federal Open Market Committee, which

currently is 0.25%. This interest rate is similar to what the Company would have received from its investments in federal funds sold, currently in a range of less than 0.25%. Furthermore, Federal Reserve Bank balances are 100% secured.

As liquidity levels vary continuously based on consumer activities, amounts of cash and cash equivalents can vary widely at any given point in time. Carrying excess cash has a negative impact on interest income since the Company currently only earns 0.25% on its deposits with the Federal Reserve. As a result, the Company's focus will be to re-invest these excess funds back into longer-term, higher-yielding assets, primarily loans, when the opportunities arise.

#### Certificates of deposit

At June 30, 2015, the Company had \$980 in certificates of deposit, owned by the Captive and unchanged from year-end 2014. The investment consisted of four certificates with maturity terms ranging from one to three years.

#### Securities

The balance of total securities decreased \$1,179, or 1.1%, compared to year-end 2014. This decrease came mostly from obligations of state and political subdivisions, which decreased \$905, or 4.0%, from year-end 2014, impacted by investment redemptions during the second quarter. In addition, the Company's U.S. Government agency ("Agency") mortgage-backed securities decreased \$343, or 0.4%, from year-end 2014. The Company's investment securities portfolio is made up mostly of Agency mortgage-backed securities, representing 71.1% of total investments at June 30, 2015. During the second quarter of 2015, the Company sold \$8,658 in Agency mortgage-backed securities that were collectively yielding 1.34% at a gain of \$135. This gain on sale contributed to the Company's 2015 quarter-to-date net growth in noninterest income. The Company used the proceeds from the sale to reinvest in new Agency mortgage-backed securities totaling \$9,053 at an interest yield of 2.0%, which had a positive impact on the net interest margin. During the second half of 2015, the Company received principal repayments of \$7,784. The monthly repayment of principal has been the primary advantage of Agency mortgage-backed securities as compared to other types of investment securities, which deliver proceeds upon maturity or call date. In addition, the unrealized gain associated with Agency mortgage-backed securities was negatively affected by an increase in market rates during the second quarter of 2015. As a result, the unrealized fair value of the Company's Agency mortgage-backed securities decreased from \$1,930 at March 31, 2015 to \$833 at June 30, 2015. These changes in rates are typical and do not impact earnings of the Company as long as the securities are held to full maturity.

#### Loans

The loan portfolio represents the Company's largest asset category and is its most significant source of interest income. Gross loan balances of \$592,899 at June 30, 2015 represented a decrease of \$1,869 when compared to \$594,768 in loan balances at year-end 2014. Contributing most to this decrease was the commercial real estate segment, which decreased \$3,590, or 2.0%, from year-end 2014. The decrease has been impacted by unanticipated loan payoffs, competitive pricing pressures and a general decrease in loan demand. The decrease has come primarily from owner-occupied and construction loans. Commercial real estate loans comprise the largest portion of the Company's total commercial loan portfolio, representing 67.0% at June 30, 2015. Partially offsetting lower commercial real estate loans were higher balances within the commercial and industrial loan portfolio, which increased \$1,575, or 1.9%, from year-end 2014. Commercial and industrial loans consist of loans to corporate borrowers primarily in small to mid-sized industrial and commercial companies that include service, retail and wholesale merchants. Collateral securing these loans includes equipment, inventory, and stock. While management believes lending opportunities exist in the Company's markets, future commercial lending activities will depend upon economic and related conditions, such as general demand for loans in the Company's primary markets, interest rates offered by the Company, the effects of competitive pressure and normal underwriting considerations. Management will continue to place emphasis on its commercial lending, which generally yields a higher return on investment as compared to other types of loans.



Residential real estate loan balances comprise the largest portion of the Company's overall loan portfolio at 37.9% and consist primarily of one- to four-family residential mortgages and carry many of the same customer and industry risks as the commercial loan portfolio. Residential real estate loan balances during the first half of 2015 increased \$1,295, or 0.6%, from year-end 2014. Movement within the real estate portfolio consists of decreasing long-term fixed-rate mortgages being completely offset by increasing short-term adjustable-rate mortgage balances. As part of management's interest rate risk strategy, the Company continues to sell most of its long-term fixed-rate residential mortgages to the Federal Home Loan Mortgage Corporation, while maintaining the servicing rights for those mortgages. A customer that does not qualify for a long-term, secondary market loan may choose from one of the Company's other adjustable-rate mortgage products, which contributed to higher balances of adjustable-rate mortgages from year-end 2014.

Consumer loan balances decreased \$1,149, or 1.0%, from year-end 2014. This decrease was impacted most by an 8.1% decrease in other consumer loan balances that include mobile homes, recreational vehicles, consumer real estate and unsecured loans. This decrease was partially offset by a 10.1% increase in home equity lines of credit balances and a 2.1% increase in automobile loans. Automobile loans represent the Company's largest consumer loan type at 40.4% of total consumer loans. The Company will continue to monitor its auto lending segment while maintaining strict loan underwriting processes to limit future loss exposure.

#### Allowance for Loan Losses

The Company had a \$7,444 allowance for loan losses at June 30, 2015, which was down from the \$8,334 allowance at year-end 2014. The allowance was impacted mostly by lower specific allocations from year-end 2014, which decreased \$718, or 21.0%. Specific allocations of the allowance for loan losses identify loan impairment by measuring fair value of the underlying collateral and the present value of estimated future cash flows. During the second quarter of 2015, a \$1,304 charge-off was taken on an existing specific allocation of a collateral dependent impaired commercial real estate loan. This specific allocation had already been provided for during the fourth quarter of 2014 as a result of asset impairment based on collateral values. As a result, the charge-off of this specific allocation did not have an impact to provision expense in 2015. Partially offsetting this decrease in specific reserves was the asset impairment of one commercial and industrial loan relationship that required specific reserves of \$586 and a corresponding increase to provision expense to be recorded in the second quarter of 2015.

As part of the Company's quarterly analysis of the allowance for loan losses, management also reviewed various factors that directly impact the general allocation need of the allowance, which include: historical loan losses, loan delinquency levels, local economic conditions and unemployment rates, criticized/classified asset coverage levels and loan loss recoveries. Although the Company experienced an increase in net loan charge-offs during the quarterly and year-to-date periods ending June 30, 2015, the average historical loan loss factor was down from year-end 2014. The average historical loan loss factor is based on a 5-year loan loss history for commercial loans and 3 years for real estate and consumer loans. Furthermore, the Company experienced a decrease (improvement) in its classified assets from year-end 2014, which contributed to a lower economic risk factor. As a result, the general allocation component of the allowance for loan losses decreased \$172, or 3.5%, from year-end 2014.

The Company experienced a decrease in its troubled assets, with nonperforming loans to total loans finishing at 1.45% at June 30, 2015, down from 1.62% at year-end 2014. The Company's nonperforming assets to total assets totaled 1.27% at June 30, 2015, a decrease from 1.43% at year-end 2014. In addition, impaired loans at June 30, 2015 also decreased \$264, or 1.3%, from year-end 2014.

The Company maintained its allowance for loan losses to total loans ratio at 1.26% at June 30, 2015 and 1.40% at year-end 2014. Management believes that the allowance for loan losses at June 30, 2015 was adequate and reflected probable incurred losses in the loan portfolio. There can be no assurance, however, that adjustments to the allowance

for loan losses will not be required in the future. Changes in the circumstances of particular borrowers, as well as adverse developments in the economy are factors that could change and make adjustments to the allowance for loan losses necessary. Asset quality will continue to remain a key focus, as management continues to stress not just loan growth, but quality in loan underwriting as well.

## Deposits

Deposits continue to be the most significant source of funds used by the Company to meet obligations for depositor withdrawals, to fund the borrowing needs of loan customers, and to fund ongoing operations. Total deposits at June 30, 2015 increased \$19,458, or 3.0%, from year-end 2014. A portion of this deposit growth came from noninterest-bearing deposit balances, which were up \$10,625, or 6.6%, from year-end 2014. The increase came largely from business checking and incentive-based checking products. Business checking balances were impacted by the seasonal ERC/ERD tax refund items processed mostly during the first quarter of 2015. The Company has benefited from the successful volume increase in ERC/ERD transactions during 2015. As a result of the tax processing activity being seasonal, the elevated balances within the Company's business checking accounts should continue to decrease during the remainder of 2015.

Deposit growth also came from interest-bearing NOW account balances, which increased \$13,195, or 11.7%, during the first half of 2015 as compared to year-end 2014. This increase was largely driven by public fund balances related to local city and county school accounts within Gallia County, Ohio.

During the first half of 2015, time deposits decreased \$5,171, or 3.0%, from year-end 2014. With the spread between a short-term CD rate and a statement savings rate being limited, many customers choose to invest balances into a more liquid product, perhaps hoping for rising rates in the near future. This change in time deposits from year-end 2014 fits within management's strategy of focusing on more "core" deposit balances that include interest-bearing demand, savings, money market and noninterest-bearing deposit balances.

While facing increased competition for deposits in its market areas, the Company will continue to emphasize growth and retention in its core deposit relationships during the remainder of 2015, reflecting the Company's efforts to reduce its reliance on higher cost funding and improving net interest income.

## Other Borrowed Funds

Other borrowed funds were \$24,322 at June 30, 2015, a decrease of \$650, or 2.6%, from year-end 2014. While deposits continue to be the primary source of funding for growth in earning assets, management will continue to utilize Federal Home Loan Bank advances and promissory notes to help manage interest rate sensitivity and liquidity.

## Shareholders' Equity

The Company maintains a capital level that exceeds regulatory requirements as a margin of safety for its depositors. At June 30, 2015, the Bank's capital exceeded the minimum requirements to be deemed "well capitalized" under applicable prompt corrective action regulations. Total shareholders' equity of the Company at June 30, 2015 of \$88,885 increased \$2,669, or 3.1%, as compared to \$86,216 at December 31, 2014. Contributing most to this increase was year-to-date net income of \$5,034, partially offset by cash dividends paid of \$1,936, or \$.47 per share. In addition, accumulated other comprehensive income decreased \$429 from year-end 2014, as increasing interest rates at the end of the second quarter caused a reduction in the fair value of the Company's investment portfolio. The fair value of an investment security moves inversely to interest rates, so as rates increased, the unrealized gain in the portfolio was negatively affected. These changes in rates are typical and do not impact earnings of the Company as long as the securities are held to full maturity.

Comparison of Results of Operations  
for the Three and Six Months Ended  
June 30, 2015 and 2014



The following discussion focuses, in more detail, on the consolidated results of operations of the Company for the three and six months ended June 30, 2015 compared to the same period in 2014. This discussion should be read in conjunction with the interim consolidated financial statements and the footnotes included in this Form 10-Q.

## Net Interest Income

The most significant portion of the Company's revenue, net interest income, results from properly managing the spread between interest income on earning assets and interest expense incurred on interest-bearing liabilities. During the second quarter of 2015, net interest income decreased \$38, or 0.5%, as compared to the second quarter of 2014. During the six months ended June 30, 2015, net interest income increased \$110, or 0.6%, as compared to the six months ended June 30, 2014. The year-to-date improvement was largely due to increased average loans and lower premium expenses on investment securities. However, the Company continues to face net interest margin pressure affected by decreasing loan production, lower asset yields and decreasing opportunities to further reduce funding costs. This has contributed to a declining net interest margin which contributed to the second quarter decline in net interest income.

Total interest and fee income recognized on the Company's earning assets decreased \$59, or 0.7%, during the second quarter of 2015, which limited the Company's year-to-date interest and fee increase to \$60, or 0.3%, as compared to the same periods in 2014. The year-to-date increase was mostly impacted by increased earnings within investment securities, which have increased \$49, or 4.4%, over the first half of 2014, coming primarily from Agency mortgage-backed securities. The effect of slower refinancing volume evident during the first half of 2015 has resulted in less principal repayments from Agency mortgage-backed securities, causing monthly premium expense to amortize more slowly. Year-to-date average loan growth experienced in all loan portfolio segments, led by commercial loans, also contributed to higher interest income during the first half of 2015 over 2014. During the quarter-to-date period ending June 30, 2015, the Company experienced a decrease in average loans when compared to the linked first quarter of 2015, mostly impacted by commercial loans, which contributed to lower interest income. Declining interest revenues during the quarter-to-date ended June 30, 2015 were also impacted by lower asset yields. Asset yields on the Company's earning assets have been negatively impacted by lower market rates within the loan portfolio, as well as a composition shift from higher-yielding, long-term fixed-rate mortgages to lower-yielding, short-term adjustable-rate mortgages. Asset yields have also been impacted by higher average balances within the Company's lower-yielding Federal Reserve Bank clearing account during the first half of 2015. As a result, the earning asset yield at June 30, 2015 was 4.70%, compared to 4.87% at June 30, 2014.

Total interest expense incurred on the Company's interest-bearing liabilities during the second quarter of 2015 decreased \$21, or 2.8%, and decreased \$50, or 3.4%, during the six months ended June 30, 2015, as compared to the same periods in 2014. The decrease was primarily due to a sustained low-rate environment that has impacted the repricings of various Bank deposit products, especially time deposit balances, which continued to reprice at lower rates during 2015. As a result, the Company's weighted average costs for time deposits decreased from 0.85% at June 30, 2014 to 0.75% at June 30, 2015. The Company also continues to utilize more of its lower cost, core deposit funding sources to further lower interest costs. As a result, the Company's average interest- and non-interest bearing core deposits increased \$20,849, or 3.9%, while average time deposit balances increased \$908, or 0.5%, during the first half of 2015 when compared to the same period in 2014. As a result of decreases in the average market interest rates and the continued emphasis on utilizing lower costing deposit balances, the Company's total weighted average costs on interest-bearing deposits have lowered 4 basis points from 0.48% at June 30, 2014 to 0.44% at June 30, 2015.

During 2015, the decline in asset yields completely offset the decline in funding costs. As a result, the Company's net interest margin decreased 22 basis points to 4.24% during the second quarter of 2015, and decreased 14 basis points to 4.35% during the first half of 2015, as compared to the same periods in 2014. The Company will continue to focus on re-deploying the excess liquidity retained within the Federal Reserve account earning 0.25% into higher yielding assets as opportunities arise. The Company will continue to face pressure on its net interest income and margin improvement unless loan balances continue to expand and remain a larger component of overall earning assets.



### Provision for Loan Losses

During the second quarter of 2015, provision expense charges decreased \$587, or 42.4%, and decreased \$1,159, or 61.6%, during the first half of 2015, as compared to the same periods in 2014. The decline in provision expense during both the quarter-to-date and year-to-date periods were mostly from various events that occurred during the first and second quarters of 2014 that had a reverse effect in 2015.

During the first quarter of 2014, provision expense was primarily impacted by several general allocation metrics that were re-evaluated and adjusted, contributing to higher general allocations within the residential real estate and commercial loan portfolios. Adjustments were made to the commercial loan loss factor, extending the range of the loan loss period from a 3-year rolling average to a 5-year rolling average. This update was due to the significant decline in net charge-offs that had been experienced since the first quarter of 2012 that was reducing the historical loan loss factor for commercial loans. By extending the historical loss period to five years, management felt the historical factor would be more representative of the expected losses to be incurred on commercial loans. Management also increased the economic risk factor by adjusting its criticized/classified asset thresholds to incorporate more risk potential within the Company's special mention and substandard loan portfolios.

During the second quarter of 2014, two impaired commercial credits totaling \$12,000 were downgraded due to decreasing cash flows causing classified assets to increase, which impacted the economic risk factor within the allowance for loan loss calculation and required corresponding charges to provision expense.

Since June 2014, the Company has experienced improvements (declines) in its loan loss history, as well as in both criticized and classified asset portfolios, which have yielded less provision expense and lower general allocations in 2015.

The impacts of lower general allocations were partially offset by changes in specific allocations during 2015, which required additional provision expense. As previously mentioned, a \$1,304 charge-off was taken during the second quarter of 2015 on an existing specific allocation of a collateral dependent impaired commercial real estate loan. Since the specific allocation was recorded during the previous year, no provision expense was required in 2015. However, the Company did identify the asset impairment of one commercial and industrial loan relationship that required specific reserves of \$586 and a corresponding increase to provision expense that was recorded in the second quarter of 2015.

Future provisions to the allowance for loan losses will continue to be based on management's quarterly in-depth evaluation that is discussed in further detail under the caption "Critical Accounting Policies - Allowance for Loan Losses" within this Management's Discussion and Analysis.

### Noninterest Income

Noninterest income for the six months ended June 30, 2015 was \$5,406, a decrease of \$624, or 10.3%, from the six months ended June 30, 2014. However, noninterest income showed improvement during the second quarter of 2015, increasing \$5, or 0.3%, over the same period in 2014. Noninterest income during 2015 was negatively affected by the Company's seasonal ERC/ERD fees, which decreased \$159, or 38.4%, during the second quarter of 2015, and \$712, or 23.3%, during the first half of 2015, as compared to the same periods in 2014. In October 2014, the Bank entered into a new agreement with a third-party tax refund product provider, which lowered the per transaction fee associated with each refund facilitated. As a result, even though the Company experienced an increase in the number of ERC/ERD transactions that were facilitated, the lower fee structure caused tax processing revenues to be lower than the year before. As a result of ERC/ERD fee activity being mostly seasonal, only minimal income is expected during the second half of 2015.

Lower noninterest income during the first half of 2015 also came from the Company's gain on sale of its 9% ownership interest in ProAlliance of \$135 during the first quarter of 2014. This represented the first of two installments the Company received during 2014. The first installment of \$135 was received on February 5, 2014, when the Company received its pro rata share of a non-refundable fee giving the buyers an option to purchase the outstanding shares of ProAlliance. On August 1, 2014, the buyer exercised its option to purchase the shares and the Company received \$675 for its ownership interest in ProAlliance.

Having a positive contribution to noninterest income during both the quarterly and year-to-date periods of 2015 was the gain on sale of securities. As previously mentioned, during the second quarter of 2015, the Company sold some of its lower-yielding, Agency mortgage-backed securities at a gain of \$135, while reinvesting the proceeds into higher-yielding securities. Not only did this shift of balances to higher-yielding assets have a positive effect on the margin, the gain on sale contributed to the Company's 2015 quarter-to-date net growth in noninterest income.

The Company's remaining noninterest income categories were collectively up \$29, or 1.9%, during the second quarter of 2015, and up \$88, or 3.1%, during the first half of 2015, when compared to the same period in 2014. These changes were primarily due to increases in debit/credit card interchange fees and higher gains on the sale of OREO property.

#### Noninterest Expense

Noninterest expense during the second quarter of 2015 increased \$557, or 8.0%, and increased \$689, or 4.8%, during the first half of 2015, as compared to the same periods in 2014. Contributing to the increase in net overhead expense were higher salaries and employee benefits, data processing expense and accounting expense.

The Company's largest noninterest expense item, salaries and employee benefits, increased \$191, or 4.5%, during the three months ended June 30, 2015, and increased \$214, or 2.5%, during the six months ended June 30, 2015, as compared to the same periods in 2014. The increase was largely due to annual merit increases and higher retirement benefit costs.

Further impacting noninterest expense was data processing expense, which increased \$69, or 23.5%, during the second quarter of 2015, and increased \$116, or 18.9%, during the first half of 2015, as compared to the same periods in 2014. Monthly data processing costs have increased from last year in large part due to the volume increase within the Company's debit and credit card transactions, as well as its Big Rewards customer incentive platform.

Other noninterest expenses during 2015 were also up over the prior quarter and year-to-date periods of 2014. This came mostly from increases in accounting and audit related service fees, which increased \$48, or 23.5%, during the second quarter of 2015, and increased \$96, or 18.9%, during the first half of 2015, as compared to the same periods in 2014.

The Company's remaining noninterest expense categories were collectively up \$249, or 10.4%, during the second quarter of 2015, and up \$263, or 5.4%, during the first half of 2015, when compared to the same periods in 2014. These changes were primarily due to expense increases in furniture and equipment, FDIC insurance, software maintenance and customer incentives.

The Company's efficiency ratio is defined as noninterest expense as a percentage of fully tax-equivalent net interest income plus noninterest income. The effects from provision expense are excluded from the efficiency ratio. Management continues to place emphasis on managing its balance sheet mix and interest rate sensitivity as well as developing more innovative ways to generate noninterest revenue. Although average earning assets remain at higher levels over the prior year, the Company continues to experience a declining net interest margin, which puts pressure on net interest income growth going forward. At the same time, higher employee benefit costs combined with a 23.3% decline in tax processing fees caused overhead expense to outpace net revenue levels during 2015. As a result, the Company's efficiency ratios have regressed, finishing at 73.8% and 65.6% during both the quarterly and year-to-date periods ended June 30, 2015, as compared to 68.2% and 61.3% for the same periods in 2014.

#### Capital Resources

In July 2013, each of the federal bank regulatory agencies issued a final new capital rule that revised its risk-based capital requirements and the method for calculating risk-weighted assets (“RWA”) to make them consistent with agreements that were published by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. The rule was effective for the Company and the Bank on January 1, 2015. The new rule will both improve the quality and increase the quantity of capital required to be held by banking organizations. The new minimum capital to RWA requirements are a new common equity Tier 1 risk-based capital ratio of 4.5%, a Tier 1 risk-based capital ratio of 6% (increased from the previous 4% requirement), and a total risk-based capital ratio that remains at 8%. The minimum leverage ratio remains at 4%.

The new capital rule also includes changes in the assets that qualify as regulatory capital, some of which are subject to a transition period. These changes include the phasing-out of certain instruments as qualifying capital. In addition, Tier 2 capital is no longer limited to the amount of Tier 1 capital included in total capital. Mortgage servicing rights, certain deferred tax assets and investments in unconsolidated subsidiaries over designated percentages of common stock are required to be deducted from capital, subject to a transition period. Finally, common equity Tier 1 capital includes accumulated other comprehensive income (which includes all unrealized gains and losses on available for sale debt and equity securities), subject to a transition period and a one-time opt-out election. The Company elected to opt-out of this provision. As such, accumulated comprehensive income is not included in the Company's Tier 1 capital. Starting in January 1, 2016, in order to avoid limitations on capital distributions, including dividends, the Company will be required to maintain a capital conservation buffer in excess of the minimum common equity Tier 1 capital.

The requirements in the rule will be fully phased-in by January 1, 2019. While the ultimate impact of the fully phased-in capital standards on the Company and the Bank is still being considered, we currently do not believe the changes will have a material impact once fully implemented.

All of the Company's capital ratios exceeded the regulatory minimum guidelines, as identified in the following table:

|   | Company Ratios |                    |          |                    |
|---|----------------|--------------------|----------|--------------------|
|   | 6/30/15        | Regulatory Minimum | 12/31/14 | Regulatory Minimum |
| Common equity Tier 1 risk-based capital | 15.2%          | 4.50%              | N/A      | N/A                |
| Tier 1 risk-based capital               | 16.7%          | 6.00%              | 16.2%    | 4.00%              |
| Total risk-based capital ratio          | 18.0%          | 8.00%              | 17.4%    | 8.00%              |
| Leverage ratio                          | 11.5%          | 4.00%              | 11.8%    | 4.00%              |

Cash dividends paid of \$1,936 during the first half of 2015 represents a 12.4% increase compared to the cash dividends paid during the same period in 2014. In the first half of 2014, Ohio Valley paid two quarterly dividends of \$0.21 each. In the first half of 2015, Ohio Valley paid two quarterly dividends of \$0.21 each and a special dividend of \$0.05.

### Liquidity

Liquidity relates to the Company's ability to meet the cash demands and credit needs of its customers and is provided by the ability to readily convert assets to cash and raise funds in the market place. Total cash and cash equivalents, held to maturity securities maturing within one year and available for sale securities, totaling \$137,453, represented 17.2% of total assets at June 30, 2015. In addition, the FHLB offers advances to the Bank, which further enhances the Bank's ability to meet liquidity demands. At June 30, 2015, the Bank could borrow an additional \$115,749 from the FHLB, of which \$75,000 could be used for short-term, cash management advances. Furthermore, the Bank has established a borrowing line with the Federal Reserve. At June 30, 2015, this line had total availability of \$41,205. Lastly, the Bank also has the ability to purchase federal funds from a correspondent bank.



### Off-Balance Sheet Arrangements

As discussed in Note 5 – Financial Instruments with Off-Balance Sheet Risk, the Company engages in certain off-balance sheet credit-related activities, including commitments to extend credit and standby letters of credit, which could require the Company to make cash payments in the event that specified future events occur. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Standby letters of credit are conditional commitments to guarantee the performance of a customer to a third party. While these commitments are necessary to meet the financing needs of the Company's customers, many of these commitments are expected to expire without being drawn upon. Therefore, the total amount of commitments does not necessarily represent future cash requirements.

### Critical Accounting Policies

The most significant accounting policies followed by the Company are presented in Note A to the financial statements in the Company's 2014 Annual Report to Shareholders. These policies, along with the disclosures presented in the other financial statement notes, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Management views critical accounting policies to be those which are highly dependent on subjective or complex judgments, estimates and assumptions, and where changes in those estimates and assumptions could have a significant impact on the financial statements. Management currently views the adequacy of the allowance for loan losses to be a critical accounting policy.

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans generally consist of loans with balances of \$200 or more on nonaccrual status or nonperforming in nature. Loans for which the terms have been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length and reasons for the delay, the borrower's prior payment record, and the amount of shortfall in relation to the principal and interest owed.

Commercial and commercial real estate loans are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Smaller balance homogeneous loans, such as consumer and most residential real estate, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosure. Troubled debt restructurings are measured at the present value of estimated future cash flows using the loan's effective rate at

inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component covers non-impaired loans and impaired loans that are not individually reviewed for impairment and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company over the most recent 3 years for the consumer and real estate portfolio segment and 5 years for the commercial portfolio segment. The total loan portfolio's actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments have been identified: Commercial Real Estate, Commercial and Industrial, Residential Real Estate, and Consumer.

Commercial and industrial loans consist of borrowings for commercial purposes by individuals, corporations, partnerships, sole proprietorships, and other business enterprises. Commercial and industrial loans are generally secured by business assets such as equipment, accounts receivable, inventory, or any other asset excluding real estate and generally made to finance capital expenditures or operations. The Company's risk exposure is related to deterioration in the value of collateral securing the loan should foreclosure become necessary. Generally, business assets used or produced in operations do not maintain their value upon foreclosure, which may require the Company to write down the value significantly to sell.

Commercial real estate consists of nonfarm, nonresidential loans secured by owner-occupied and nonowner-occupied commercial real estate as well as commercial construction loans. An owner-occupied loan relates to a borrower purchased building or space for which the repayment of principal is dependent upon cash flows from the ongoing business operations conducted by the party, or an affiliate of the party, who owns the property. Owner-occupied loans that are dependent on cash flows from operations can be adversely affected by current market conditions for their product or service. A nonowner-occupied loan is a property loan for which the repayment of principal is dependent upon rental income associated with the property or the subsequent sale of the property. Nonowner-occupied loans that are dependent upon rental income are primarily impacted by local economic conditions which dictate occupancy rates and the amount of rent charged. Commercial construction loans consist of borrowings to purchase and develop raw land into one- to four-family residential properties. Construction loans are extended to individuals as well as corporations for the construction of an individual or multiple properties and are secured by raw land and the subsequent improvements. Repayment of the loans to real estate developers is dependent upon the sale of properties to third parties in a timely fashion upon completion. Should there be delays in construction or a downturn in the market for those properties, there may be significant erosion in value which may be absorbed by the Company.

Residential real estate loans consist of loans to individuals for the purchase of one- to four-family primary residences with repayment primarily through wage or other income sources of the individual borrower. The Company's loss exposure to these loans is dependent on local market conditions for residential properties as loan amounts are determined, in part, by the fair value of the property at origination.

Consumer loans are comprised of loans to individuals secured by automobiles, open-end home equity loans and other loans to individuals for household, family, and other personal expenditures, both secured and unsecured. These loans typically have maturities of 6 years or less with repayment dependent on individual wages and income. The risk of loss on consumer loans is elevated as the collateral securing these loans, if any, rapidly depreciate in value or may be worthless and/or difficult to locate if repossession is necessary. During the last several years, one of the most significant portions of the Company's net loan charge-offs have been from consumer loans. Nevertheless, the Company has allocated the highest percentage of its allowance for loan losses as a percentage of loans to the other identified loan portfolio segments due to the larger dollar balances associated with such portfolios.



## Concentration of Credit Risk

The Company maintains a diversified credit portfolio, with residential real estate loans currently comprising the most significant portion. Credit risk is primarily subject to loans made to businesses and individuals in southeastern Ohio and western West Virginia. Management believes this risk to be general in nature, as there are no material concentrations of loans to any industry or consumer group. To the extent possible, the Company diversifies its loan portfolio to limit credit risk by avoiding industry concentrations.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's goal for interest rate sensitivity management is to maintain a balance between steady net interest income growth and the risks associated with interest rate fluctuations. Interest rate risk ("IRR") is the exposure of the Company's financial condition to adverse movements in interest rates. Accepting this risk can be an important source of profitability, but excessive levels of IRR can threaten the Company's earnings and capital.

The Company evaluates IRR through the use of an earnings simulation model to analyze net interest income sensitivity to changing interest rates. The modeling process starts with a base case simulation, which assumes a static balance sheet and flat interest rates. The base case scenario is compared to rising and falling interest rate scenarios assuming a parallel shift in all interest rates. Comparisons of net interest income and net income fluctuations from the flat rate scenario illustrate the risks associated with the current balance sheet structure.

The Company's Asset/Liability Committee monitors and manages IRR within Board approved policy limits. The current IRR policy limits anticipated changes in net interest income to an instantaneous increase or decrease in market interest rates over a 12 month horizon to +/- 5% for a 100 basis point rate shock, +/- 7.5% for a 200 basis point rate shock and +/- 10% for a 300 basis point rate shock. Based on the level of interest rates, management did not test interest rates down 200 or 300 basis points.

The following table presents the Company's estimated net interest income sensitivity:

|  | June 30, 2015                                     | December 31,<br>2014                              |
|--|---|---|
| Change in<br>Interest Rates<br>in Basis Points | Percentage<br>Change in<br>Net Interest<br>Income | Percentage<br>Change in<br>Net Interest<br>Income |
| +300   | .07%  | (2.08%)   |
| +200   | .24%  | (1.16%)   |
| +100   | .21%  | (.49%)  |
| -100   | (3.04%)   | (2.81%)   |

The estimated percentage change in net interest income due to a change in interest rates was within the policy guidelines established by the Board. With the historical low interest rate environment, management generally has been focused on limiting the duration of assets, while trying to extend the duration of our funding sources to the extent customer preferences will permit the Company to do so. At June 30, 2015, the interest rate risk profile reflects a modest asset sensitive position, which produces higher net interest income due to an increase in interest rates. This is a change from the liability sensitive position at year end. Contributing to the change in interest rate risk profile, was the increase in liquidity due to tax refund processing. The additional liquidity is maintained in an interest-bearing account at the Federal Reserve and the interest rate is highly correlated to any rate change implemented by the Federal Reserve as part of its monetary policy. Since the deposit balance associated with tax refund processing is seasonal,

management expects a portion of the balance maintained at the Federal Reserve to decline in subsequent quarters, which will reduce or eliminate our asset sensitive position. In a declining rate environment, net interest income is impacted by the interest rate on many deposit accounts not being able to adjust downward. With interest rates so low, deposit accounts are perceived to be at or near an interest rate floor. As a result, net interest income decreases in a declining interest rate environment. Overall, management is comfortable with the current interest rate risk profile which reflects minimal exposure to interest rate changes.

ITEM 4. CONTROLS AND PROCEDURES