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

## FORM 10-Q

## AmeriServ Financial, Inc.

(Exact name of registrant as specified in its charter)

Pennsylvania
(State or other jurisdiction of incorporation or organization)

25-1424278
(I.R.S. Employer

Identification No.)
Main \& Franklin Streets, P.O. Box 430, Johnstown, PA (Address of principal executive offices)

15907-0430
(Zip Code)

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

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

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 x No o

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

Large accelerated filer o Accelerated filer o Non-accelerated filer o Smaller reporting company x Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).Yes o No x

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

Class
Common Stock, par value $\$ 0.01$

Outstanding at August 1, 2013
18,784,188

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## Item 1. Financial Statements

## AMERISERV FINANCIAL, INC. CONSOLIDATED BALANCE SHEETS <br> (In thousands) (Unaudited)

|  | June 30, | December 31, |
| :--- | :--- | :--- |
|  | 2013 | 2012 |
| ASSETS |  |  |
| Cash and due from depository institutions | $\$ 16,364$ | $\$ 17,808$ |
| Interest bearing deposits | 2,965 | 1,730 |
| Short-term investments in money market funds | 6,326 | 7,282 |
| Total cash and cash equivalents | 25,655 | 26,820 |
| Investment securities: |  |  |
| Available for sale | 149,656 | 151,538 |
| Held to maturity (fair value \$18,479 on June 30, 2013 and \$14,266 on | 18,628 | 13,723 |
| December 31, 2012) | 6,625 | 10,576 |
| Loans held for sale | 745,516 | 721,802 |
| Loans | 619 | 637 |
| Less: Unearned income | 11,145 | 12,571 |
| Allowance for loan losses | 733,752 | 708,594 |
| Net loans | 12,844 | 11,798 |
| Premises and equipment, net | 3,242 | 2,960 |
| Accrued interest income receivable | 12,613 | 12,613 |
| Goodwill | 36,260 | 36,214 |
| Bank owned life insurance | 11,606 | 11,467 |
| Net deferred tax asset | 4,866 | 4,179 |
| Federal Home Loan Bank stock | 2,125 | 2,125 |
| Federal Reserve Bank stock |  | 1,444 |
| Prepaid federal deposit insurance | 7,212 | 6,940 |
| Other assets | $\$ 1,025,084$ | $\$ 1,000,991$ |
| TOTAL ASSETS |  |  |
| LIABILITIES | $\$ 159,287$ | $\$ 156,223$ |
| Non-interest bearing deposits | 680,985 | 679,511 |
| Interest bearing deposits | 840,272 | 835,734 |
| Total deposits | 34,292 | 15,660 |
| Short-term borrowings | 16,000 | 13,000 |
| Advances from Federal Home Loan Bank | 13,085 | 13,085 |
| Guaranteed junior subordinated deferrable interest debentures | 63,377 | 41,745 |
| Total borrowed funds | 12,153 | 13,044 |
| Other liabilities | 915,802 | 890,523 |
| TOTAL LIABILITIES |  |  |


| SHAREHOLDERS' EQUITY |  |  |
| :--- | :--- | :--- |
| Preferred stock, no par value; $\$ 1,000$ per share liquidation preference; |  |  |
| 2,000,000 shares authorized; 21,000 shares issued and outstanding on June | 21,000 | 21,000 |
| 30, 2013 and December 31, 2012 |  |  |
| $\left.\begin{array}{lll}\text { Common stock, par value } \$ 0.01 \text { per share; } 30,000,000 ~ s h a r e s ~ a u t h o r i z e d ; ~ & & \\ \text { 26,402,007 shares issued and 18,784,188 outstanding on June 30, 2013; } & 264 & 264 \\ \text { 26,398,540 shares issued and 19,164,721 outstanding on December 31, } & & \\ \text { 2012 } & & \\ \text { Treasury stock at cost, 7,617,819 and 7,233,819 shares on June 30, 2013 } & (74,829 & (73,658 \\ \text { and December 31, 2012, respectively } & 145,139 & 145,102 \\ \text { Capital surplus } & 24,971 & 23,139 \\ \text { Retained earnings } & (7,263 & (5,379\end{array}\right)$ |  |  |
| Accumulated other comprehensive loss, net | 109,282 | 110,468 |
| TOTAL SHAREHOLDERS' EQUITY | $\$ 1,025,084$ | $\$ 1,000,991$ |

See accompanying notes to unaudited consolidated financial statements.

# AMERISERV FINANCIAL, INC. CONSOLIDATED STATEMENTS OF OPERATIONS (In thousands, except per share data) (Unaudited) 

| INTEREST INCOME |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- |
| Interest and fees on loans | $\$ 8,590$ | $\$ 8,552$ | $\$ 17,218$ | $\$ 17,281$ |
| Interest bearing deposits | 3 | 5 | 4 | 6 |
| Short-term investments in money market funds | 4 | 7 | 6 | 10 |
| Investment securities: |  |  |  |  |
| Available for sale | 907 | 1,210 | 1,863 | 2,489 |
| Held to maturity | 123 | 111 | 238 | 223 |
| Total Interest Income | 9,627 | 9,885 | 19,329 | 20,009 |
| INTEREST EXPENSE |  |  |  |  |
| Deposits | 1,288 | 1,668 | 2,638 | 3,430 |
| Short-term borrowings | 8 |  | 13 | 4 |
| Advances from Federal Home Loan Bank | 30 | 16 | 55 | 36 |
| Guaranteed junior subordinated deferrable interest | 280 | 280 | 560 | 560 |
| debentures | 1,606 | 1,964 | 3,266 | 4,030 |
| Total Interest Expense | 8,021 | 7,921 | 16,063 | 15,979 |
| NET INTEREST INCOME | 150 | $(500$ | $(100$ | $(1,125)$ |
| Provision (credit) for loan losses | 7,871 | 8,421 | 16,163 | 17,104 |
| NET INTEREST INCOME AFTER PROVISION |  |  |  |  |
| (CREDIT) FOR LOAN LOSSES | 1,779 | 1,628 | 3,446 | 3,325 |
| NON-INTEREST INCOME | 220 | 177 | 434 | 370 |
| Trust fees |  | 12 | 71 | 12 |
| Investment advisory fees | 241 | 251 | 627 | 527 |
| Net realized gains on investment securities | 538 | 517 | 1,049 | 1,052 |
| Net gains on sale of loans | 388 | 212 | 589 | 427 |
| Service charges on deposit accounts | 909 | 936 | 1,675 | 1,694 |
| Bank owned life insurance | 4,075 | 3,733 | 7,891 | 7,407 |
| Other income |  |  |  |  |
| Total Non-Interest Income | 6,176 | 5,976 | 12,507 | 11,962 |
| NON-INTEREST EXPENSE | 751 | 702 | 1,524 | 1,431 |
| Salaries and employee benefits | 455 | 473 | 910 | 924 |
| Net occupancy expense | 1,150 | 937 | 2,185 | 1,860 |
| Equipment expense | 211 | 200 | 422 | 433 |
| Professional fees | 365 | 355 | 741 | 710 |
| Supplies, postage and freight |  |  |  |  |

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| Federal deposit insurance expense | 151 | 114 | 285 | 243 |
| :--- | :--- | :--- | :--- | :--- |
| Other expense | 1,183 | 1,310 | 2,490 | 2,618 |
| Total Non-Interest Expense | 10,442 | 10,067 | 21,064 | 20,181 |
| PRETAX INCOME | 1,504 | 2,087 | 2,990 | 4,330 |
| Provision for income tax expense | 434 | 655 | 864 | 1,333 |
| NET INCOME | 1,070 | 1,432 | 2,126 | 2,997 |
| Preferred stock dividends | 52 | 262 | 104 | 525 |
| NET INCOME AVAILABLE TO COMMON | $\$ 1,018$ | $\$ 1,170$ | $\$ 2,022$ | $\$ 2,472$ |
| SHAREHOLDERS |  |  |  |  |
| PER COMMON SHARE DATA: |  |  |  |  |
| Basic: | $\$ 0.05$ | $\$ 0.06$ | $\$ 0.11$ | $\$ 0.12$ |
| Net income | 19,039 | 19,584 | 19,103 | 20,132 |
| Average number of shares outstanding |  |  |  |  |
| Diluted: <br> Net income | $\$ 0.05$ | $\$ 0.06$ | $\$ 0.11$ | $\$ 0.12$ |
| Average number of shares outstanding | 19,128 | 19,652 | 19,192 | 20,186 |
| Cash dividends declared | $\$ 0.01$ | $\$ 0.00$ | $\$ 0.01$ | $\$ 0.00$ |

See accompanying notes to unaudited consolidated financial statements.

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# AMERISERV FINANCIAL, INC. CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) <br> (In thousands) (Unaudited) 

|  | Three Months <br> Ended June 30, |  | Six Months Ended <br> June 30, |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
|  | 2013 | 2012 | 2013 | 2012 |

See accompanying notes to unaudited consolidated financial statements.

# AMERISERV FINANCIAL, INC. CONSOLIDATED STATEMENTS OF CASH FLOWS (In thousands) (Unaudited) 

|  | Six months ended June 30, <br> 20132012 |  |
| :---: | :---: | :---: |
| OPERATING ACTIVITIES |  |  |
| Net income | \$2,126 | \$2,997 |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |  |
| Provision (credit) for loan losses | (100 | (1,125 ) |
| Depreciation expense | 782 | 766 |
| Net amortization of investment securities | 449 | 533 |
| Net realized gains on investment securities available for sale | (71 | (12 ) |
| Net gains on loans held for sale | (627 | (527 ) |
| Amortization of deferred loan fees | (159 | (86 ) |
| Origination of mortgage loans held for sale | $(33,789)$ | (39,517 ) |
| Sales of mortgage loans held for sale | 38,367 | 41,145 |
| Decrease (increase) in accrued interest income receivable | (282 | 57 |
| Decrease in accrued interest payable | (526 | (492 ) |
| Earnings on bank owned life insurance | (402 | (427 |
| Deferred income taxes | 831 | 1,247 |
| Stock based compensation expense | 37 | 9 |
| Decrease in prepaid Federal Deposit Insurance | 1,444 | 200 |
| Other, net | 683 | (621 ) |
| Net cash provided by operating activities | 8,763 | 4,147 |
| INVESTING ACTIVITIES |  |  |
| Purchases of investment securities available for sale | $(30,907)$ | (27,237 ) |
| Purchases of investment securities held to maturity | (6,432 ) | (3,583 ) |
| Proceeds from sales of investment securities available for sale | 1,218 | 4,221 |
| Proceeds from maturities of investment securities available for sale | 27,547 | 28,730 |
| Proceeds from maturities of investment securities held to maturity | 1,496 | 964 |
| Purchases of regulatory stock | (2,316 ) |  |
| Proceeds from redemption of regulatory stock | 1,629 | 574 |
| Long-term loans originated | $(96,463)$ | $(124,086)$ |
| Principal collected on long-term loans | 77,971 | 103,653 |
| Loans purchased or participated | (8,000 ) | (10,000 ) |
| Loans sold or participated | 1,000 | 8,500 |
| Proceeds from sale of other real estate owned | 173 | 24 |
| Proceeds from life insurance policy | 356 |  |
| Purchases of premises and equipment | (1,826 ) | (977 ) |
| Net cash used in investing activities | $(34,554)$ | $(19,217)$ |

FINANCING ACTIVITIES
$\left.\begin{array}{lll}\text { Net increase in deposit balances } & 4,459 & 37,613 \\ \text { Net increase (decrease) in other short-term borrowings } & 18,632 & (15,765\end{array}\right)$

See accompanying notes to unaudited consolidated financial statements.

# AMERISERV FINANCIAL, INC. 

# NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS 

## 1. Principles of Consolidation

The accompanying consolidated financial statements include the accounts of AmeriServ Financial, Inc. (the Company) and its wholly-owned subsidiaries, AmeriServ Financial Bank (the Bank), AmeriServ Trust and Financial Services Company (the Trust Company), and AmeriServ Life Insurance Company (AmeriServ Life). The Bank is a

Pennsylvania state-chartered full service bank with 18 locations in Pennsylvania. The Trust Company offers a complete range of trust and financial services and administers assets valued at $\$ 1.6$ billion that are not reported on the

Company s balance sheet at June 30, 2013. AmeriServ Life is a captive insurance company that engages in underwriting as a reinsurer of credit life and disability insurance.

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

## 2. Basis of Preparation

The unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. In the opinion of management, all adjustments consisting of normal recurring entries considered necessary for a fair presentation have been included.

They are not, however, necessarily indicative of the results of consolidated operations for a full-year.
For further information, refer to the consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

## 3. Accounting Policies

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. The amendments in this Update require an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles (GAAP) to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. For public entities, the amendments are effective prospectively for reporting periods beginning after December 15, 2012. The Company s disclosures reflecting the impact on its financial statements are presented in Note 12.

In July 2013, the FASB issued ASU 2013-10, Derivatives and Hedging (Topic 815): Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes. The amendments in this Update permit the Fed Funds Effective Swap Rate (OIS) to be used as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to UST and LIBOR. The amendments also remove the restriction on using different benchmark rates for similar hedges. The amendments are effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. This ASU is not expected to have a significant impact on the Company s financial statements.

In July 2013, the FASB issued ASU 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. This Update applies to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss,

# AMERISERV FINANCIAL, INC. 

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 3. Accounting Policies (continued)

or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. This ASU is not expected to have a significant impact on the Company s financial statements.

## 4. Earnings Per Common Share

Basic earnings per share include only the weighted average common shares outstanding. Diluted earnings per share include the weighted average common shares outstanding and any potentially dilutive common stock equivalent shares in the calculation. Treasury shares are treated as retired for earnings per share purposes. Options and warrants to purchase 101,070 common shares, at exercise prices ranging from $\$ 3.23$ to $\$ 5.75$, and 244,083 common shares, at exercise prices ranging from $\$ 2.75$ to $\$ 6.10$, were outstanding as of June 30,2013 and 2012, respectively, but were not included in the computation of diluted earnings per common share because to do so would be antidilutive. Dividends on preferred shares are deducted from net income in the calculation of earnings per common share.

| Three months ended | Six months ended |  |
| :--- | :--- | :--- |
| June 30, | June 30, |  |
| 2013 | 2012 | 2013 |

Numerator:
Net income
Preferred stock dividends
Net income available to common shareholders
Denominator:
Weighted average common shares outstanding
(basic)
Effect of stock options
Weighted average common shares outstanding
(diluted)
Earnings per common share:
Basic $\quad \$ 0.05 \quad \$ 0.06 \quad \$ 0.11 \quad \$ 0.12$
Diluted $0.05 \quad 0.06$

## 5. Consolidated Statement of Cash Flows

On a consolidated basis, cash and cash equivalents include cash and due from depository institutions, interest-bearing deposits, federal funds sold and short-term investments in money market funds. The Company made $\$ 34,000$ in income tax payments in the first six months of 2013 as compared to $\$ 35,000$ for the first six months of 2012 . The Company made total interest payments of $\$ 3,792,000$ in the first six months of 2013 compared to $\$ 4,522,000$ in the same 2012 period. The Company had non-cash transfers to other real estate owned (OREO) in the amounts of $\$ 593,000$ and $\$ 770,000$ in the first six months of 2013 and 2012, respectively.

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## AMERISERV FINANCIAL, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 6. Investment Securities

The cost basis and fair values of investment securities are summarized as follows (in thousands):
Investment securities available for sale (AFS):

|  | June 30, 2013 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Cost <br> Basis | Gross <br> Unrealized <br> Gains | Gross <br> Unrealized <br> Losses | Fair Value |
|  |  |  |  |  |
|  |  |  |  |  |
| US Agency | \$8,049 | \$ 39 | \$ (164) | \$7,924 |
| US Agency mortgage-backed securities | 127,018 | 3,881 | (928) | 129,971 |
| Corporate bonds | 11,991 | 30 | (260 ) | 11,761 |
| Total | \$ 147,058 | \$ 3,950 | \$ (1,352 ) | \$ 149,656 |

Investment securities held to maturity (HTM):

|  | June 30, 2013 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Cost <br> Basis | Gross <br> Unrealized <br> Gains | Gross <br> Unrealized <br> Losses | Fair <br> Value |
| US Agency mortgage-backed securities | \$ 13,621 | \$ 325 | \$ (330 ) | \$ 13,616 |
| Taxable municipal | 1,012 |  | (61 ) | 951 |
| Corporate bonds and other securities | 3,995 |  | (83 ) | 3,912 |
| Total | \$ 18,628 | \$ 325 | \$ (474) | \$ 18,479 |

Investment securities available for sale (AFS):

|  | December 31, 2012 |  |  |  |  |  |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :---: | :---: | :---: | :---: | :---: |
|  | Cost | Gross | Gross | Fair |  |  |  |  |  |  |
|  | Basis | Unrealized | Unrealized | Value |  |  |  |  |  |  |
|  | $\$ 5,848$ | Gains | Losses |  |  |  |  |  |  |  |
|  | $\$ 70$ | $\$(7)$ | $\$ 5,911$ |  |  |  |  |  |  |  |
| US Agency | 131,425 | 6,320 | $(10$ | $)$ | 137,735 |  |  |  |  |  |
| US Agency mortgage-backed securities | 7,992 | 3 | $(103$ | $)$ | 7,892 |  |  |  |  |  |
| Corporate bonds | $\$ 145,265$ | $\$ 6,393$ | $\$(120$ | $)$ | $\$ 151,538$ |  |  |  |  |  |
| Total |  |  |  |  |  |  |  |  |  |  |

Investment securities held to maturity (HTM):

US Agency mortgage-backed securities Taxable municipal
Corporate bonds and other securities Total

December 31, 2012

|  | Gross | Gross |  |
| :--- | :--- | :--- | :--- |
| Cost | Unrealized | Unrealized | Fair |
| Basis | Gains | Losses | Value |
| $\$ 9,318$ | $\$ 578$ | $\$$ | $\$ 9,896$ |
| 410 | 6 |  | 416 |
| 3,995 | 14 | $(55$ | 3,954 |
| $\$ 13,723$ | $\$ 598$ | $\$(55$ | $\$ 14,266$ |

Maintaining investment quality is a primary objective of the Company's investment policy which, subject to certain limited exceptions, prohibits the purchase of any investment security below a Moody's Investor's Service or Standard \& Poor's rating of A. At June 30, 2013, $89.7 \%$ of the portfolio was rated AAA as compared to $92.2 \%$ at December 31, 2012. $1.2 \%$ of the portfolio was either rated below A or unrated at June 30, 2013. The Company has no exposure to subprime mortgage loans in the investment portfolio. At June 30, 2013, the Company s consolidated investment securities portfolio had a modified duration of approximately 2.89 years.

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## AMERISERV FINANCIAL, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 6. Investment Securities (continued)

Total proceeds from the sale of AFS securities for the first six months of 2013 were $\$ 1.2$ million resulting in $\$ 71,000$ of gross investment security gains. There were no sales of investment securities in the three months ended June 30, 2013. Total proceeds from the sale of AFS securities for the first six months of 2012 were $\$ 4.2$ million resulting in $\$ 59,000$ of gross investment security gains and $\$ 47,000$ of gross investment security losses. All of the investment security sales activity for 2012 occurred in the second quarter.

The book value of securities, both available for sale and held to maturity, pledged to secure public and trust deposits, and certain Federal Home Loan Bank borrowings was \$95,910,000 at June 30, 2013 and \$94,206,000 at December 31, 2012.

The following tables present information concerning investments with unrealized losses as of June 30, 2013 and December 31, 2012 (in thousands):

## Investment securities available for sale:

US Agency
US Agency mortgage-backed securities
Corporate bonds
Total

June 30, 2013

| Less than 12 months |  | 12 months or longer |  | Total |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Fair | Unrealized | Fair | Unreali | żdir | Unrealized |
| Value | Losses | Value | Losses | Value | Losses |
| \$5,885 | \$(164 ) | \$ | \$ | \$5,885 | \$(164 |
| 35,465 | (928 ) |  |  | 35,465 | (928 |
| 6,796 | (195 ) | 2,935 | (65) | 9,731 | (260 |
| \$48,146 | \$(1,287) | \$2,935 | \$(65 ) | \$51,081 | \$(1,352 ) |

Investment securities held to maturity:

|  | June 30, 2013 |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Less than 12 months |  |  | 12 months or longer Total |  |  |  |  |  |
|  | Fair | Unreali | zed | Fair | Unrea | ized | Fair | Unrealiz | ized |
|  | Value | Losses |  | Value | Losse |  | Value | Losses |  |
| US Agency mortgage-backed securities | \$7,594 | \$ (330 | ) | \$ | \$ |  | \$7,594 | \$ (330 | ) |
| Taxable municipal | 951 | (61 | ) |  |  |  | 951 | (61 | ) |
| Corporate bonds and other securities | 919 | (76 | ) | 2,993 | (7 | ) | 3,912 | (83 | ) |
| Total | \$9,464 | \$ (467 | ) | \$2,993 | \$ (7 | ) | \$12,457 | \$ (474 |  |

## Investment securities available for sale:

US Agency US Agency mortgage-backed securities Corporate bonds Total

December 31, 2012

| Less than | 12 months | 12 mon longer | hs or | Total |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Fair | Unrealized | Fair | Unrealized | Fair | Unrealized |
| Value | Losses | Value | Losses | Value | Losses |
| \$993 | \$ (7 | \$ | \$ | \$993 | \$ (7 |
| 1,140 | (8 | 349 | (2) | 1,489 | (10 |
| 6,898 | (103 ) |  |  | 6,898 | (103 |
| \$9,031 | \$ (118) | \$349 | \$ (2 ) | \$9,380 | \$ (120 |

# AMERISERV FINANCIAL, INC. 

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

6. Investment Securities (continued)

Investment securities held to maturity:

December 31, 2012
Less than 12
months 12 months or longer Total

| Fair | Unrealized | Fair | Unrealized | Fair | Unrealized |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Value | Losses | Value | Losses | Value | Losses |
| $\$ 965$ | $\$(35$ | $)$ | $\$ 1,981$ | $\$(20)$ | $\$ 2,946$ |
| $\$ 965$ | $\$(35)$ | $\$ 1,981$ | $\$(20)$ | $\$ 2,946$ | $\$(55)$ |

The unrealized losses are primarily a result of increases in market yields from the time of purchase. In general, as market yields rise, the value of securities will decrease; as market yields fall, the fair value of securities will increase. There are 53 positions that are considered temporarily impaired at June 30, 2013. Management generally views changes in fair value caused by changes in interest rates as temporary; therefore, these securities have not been classified as other-than-temporarily impaired. Management has also concluded that based on current information we expect to continue to receive scheduled interest payments as well as the entire principal balance. Furthermore, management does not intend to sell these securities and does not believe it will be required to sell these securities before they recover in value.

Contractual maturities of securities at June 30, 2013 are shown below (in thousands). Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without prepayment penalties.

Investment securities available for sale:

| Cost Basis | June 30, 2013 |  |  |  | Total |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  |  |
|  | US <br> Agency | US Agency <br> Mortgage-Backed <br> Securities |  | Corporate <br> Bonds | Investment Securities Available |
|  |  |  |  |  | For Sale |
| After 1 year but within 5 years | \$7,049 | \$ | 1,159 | \$ 7,993 | \$ 16,201 |
| After 5 years but within 10 years | 1,000 |  | 14,051 | 3,998 | 19,049 |
| After 10 years but within 15 years |  |  | 60,386 |  | 60,386 |
| Over 15 years |  |  | 51,422 |  | 51,422 |
| Total | \$8,049 | \$ | 127,018 | \$ 11,991 | \$ 147,058 |


|  | June 30, 2013 |  |  |  |
| :--- | :---: | :--- | :--- | :--- | :--- |
| Fair Value | US | US Agency <br> Mortgage-Backed | Total <br> Corporate <br> Investment |  |
| Bonds |  |  |  |  | | Securities |
| :--- |
| Svailable |

# AMERISERV FINANCIAL, INC. 

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 6. Investment Securities (continued)

Investment securities held to maturity:

Cost Basis

Within 1 year
After 1 year but within 5 years
After 5 years but within 10 years
After 10 years but within 15 years
Over 15 years
Total

Fair Value

Within 1 year
After 1 year but within 5 years
After 5 years but within 10 years
After 10 years but within 15 years
Over 15 years
Total

June 30, 2013
US Agency
Corporate
Mortgage-Bands and
Other

Total Investment Securities Held To
Maturity
\$ \$ 2,000 \$ 2,000
1,777
1,000
1,012
995
\$ 13,621 \$ 5,007

June 30, 2013

| US Agency | Corporate | Total |
| :---: | :---: | :---: |
|  |  | Investme |
| Mortgage-B | Backed and | Securities |
| Securities | Securities | Held To |
|  |  | Maturity |
| \$ | \$ 2,000 | \$ 2,000 |
|  | 993 | 993 |
| 1,662 |  | 1,662 |
|  | 950 | 950 |
| 11,954 | 920 | 12,874 |
| \$ 13,616 | \$ 4,863 | \$ 18,479 |

## 7. Loans

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

| June 30, | December |
| :--- | :--- |
| 2013 | 31,2012 |


| Commercial | $\$ 116,153$ | $\$ 102,822$ |
| :--- | :---: | :---: |
| Commercial loans secured by real estate | 390,044 | 383,339 |
| Real estate mortgage | 221,736 | 217,584 |
| Consumer | 16,964 | 17,420 |
| Loans, net of unearned income | $\$ 744,897$ | $\$ 721,165$ |

Loan balances at June 30, 2013 and December 31, 2012 are net of unearned income of $\$ 619,000$ and $\$ 637,000$, respectively. Real estate-construction loans comprised $2.6 \%$, and $2.0 \%$ of total loans, net of unearned income, at June 30, 2013 and December 31, 2012, respectively. The Company has no exposure to subprime mortgage loans in the loan portfolio.

# AMERISERV FINANCIAL, INC. 

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 8. Allowance for Loan Losses

The following tables summarize the rollforward of the allowance for loan losses by portfolio segment for the three and six month periods ending June 30, 2013 and 2012 (in thousands).
Commercial
Commercial loans secured by real estate
Real estate-mortgage
Consumer
Allocation for general risk
Total
Commercial
Commercial loans secured by real estate
Real estate-mortgage
Consumer
Allocation for general risk
Total
Commercial
Commercial loans secured by real estate
Real estate-mortgage
Consumer
Allocation for general risk
Total

| Balance at March 31, 2013 | Charge-Offs |  | Recoveries |  | Provision (Credit) | Balance at June 30, 2013 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| \$ 2,667 | \$ |  | \$ | 20 | \$ 93 | \$ 2,780 |
| 5,989 |  |  |  | 34 | (40 | 5,983 |
| 1,267 | (18 | ) |  | 12 | 18 | 1,279 |
| 147 | (41 | ) |  | 28 | 12 | 146 |
| 890 |  |  |  |  | 67 | 957 |
| \$ 10,960 | \$ (59 | ) | \$ | 94 | \$ 150 | \$ 11,145 |


| Balance at <br> March 31, | Charge-Offs |
| :--- | :---: | :--- | :--- | :--- | :--- | Recoveries | Provision |
| :--- |
| (Credit) | | Balance |
| :--- |
| at June |


| Balance at December 31, 2012 | Charge-Offs |  | Recoveries | Provision (Credit) | Balance at June 30, 2013 |
| :---: | :---: | :---: | :---: | :---: | :---: |
| \$ 2,596 | \$ |  | \$ 31 | \$ 153 | \$ 2,780 |
| 7,796 | (1,480 | ) | 142 | (475) | 5,983 |
| 1,269 | (47 | ) | 67 | (10 | 1,279 |
| 150 | (79 | ) | 40 | 35 | 146 |
| 760 |  |  |  | 197 | 957 |
| \$ 12,571 | \$ (1,606 | ) | \$ 280 | \$ (100 ) | \$ 11,145 |


|  | Balance at December 31, 2011 | Charge-Offs |  | Recoveries |  | Provision (Credit) | Balance at June 30, 2012 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial | \$ 2,365 | \$ (99 | ) |  | \$ 112 | \$ (26) | \$2,352 |
| Commercial loans secured by real estate | 9,400 | (172 | ) |  | 200 | $(1,050)$ | 8,378 |
| Real estate-mortgage | 1,270 | (139 | ) |  | 29 | 46 | 1,206 |
| Consumer | 174 | (134 | ) |  | 22 | 93 | 155 |
| Allocation for general risk | 1,414 |  |  |  |  | (188) | 1,226 |
| Total | \$ 14,623 | \$ (544 | ) |  | \$ 363 | \$ (1,125) | \$ 13,317 |

As a result of successful ongoing problem credit resolution efforts, the Company achieved further asset quality improvements in the first six months of 2013. These improvements are evidenced by reduced levels of non-accrual loans, non-performing assets, classified assets and low loan delinquency levels that continue to be well below $1 \%$ of total loans. The higher charge-off in the commercial loans secured by real estate relate primarily to one loan for which a specific reserve had been previously established. The largest portion of the credit provision occurred in commercial loans secured by real-estate as this is the category that experienced the most meaningful improvement in asset quality.

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# AMERISERV FINANCIAL, INC. 

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 8. Allowance for Loan Losses <br> (continued)

The following tables summarize the loan portfolio and allowance for loan loss by the primary segments of the loan portfolio (in thousands).

|  | At June 30, 2013 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Commercial | Commercial <br> Loans <br> Secured by <br> Real Estate | Real <br> Estate- <br> Mortgage | Consumer | Total |
| Individually evaluated for impairment | \$ | \$ 2,238 | \$ | \$ 12 | \$2,250 |
| Collectively evaluated for impairment | 116,153 | 387,806 | 221,736 | 16,952 | 742,647 |
| Total loans | \$ 116,153 | \$ 390,044 | \$ 221,736 | \$ 16,964 | \$744,897 |


|  | At June 30, 2013 |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | Commercial |  | Consumer | Allocation |  |
|  | Commer | Lioans | Real |  | for | Total |
|  |  | Secured by | Mortgage |  | General |  |
| Specific reserve allocation | \$ | \$ 747 | \$ | \$ | \$ | \$ 747 |
| General reserve allocation | 2,780 | 5,236 | 1,279 | 146 | 957 | 10,398 |
| Total allowance for loan losses | \$2,780 | \$ 5,983 | \$ 1,279 | \$ 146 | \$ 957 | \$ 11,145 |


|  | At December 31, 2012 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Commercia | Commercial <br> Loans <br> Secured by <br> Real Estate | Real <br> Estate- <br> Mortgage | Consumer | Total |
| Individually evaluated for impairment | \$ | \$ 4,793 | \$ | \$ 13 | \$4,806 |
| Collectively evaluated for impairment | 102,822 | 378,546 | 217,584 | 17,407 | 716,359 |
| Total loans | \$ 102,822 | \$ 383,339 | \$ 217,584 | \$ 17,420 | \$721,165 |

At December 31, 2012
Commerci@ommercial Real Consumer Allocation Total Loans Estatefor

|  |  | Secured by <br> Real Estate | Mortgage |  | General Risk |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Specific reserve allocation | \$ | \$ 1,586 | \$ | \$ | \$ | \$ 1,586 |
| General reserve allocation | 2,596 | 6,210 | 1,269 | 150 | 760 | 10,985 |
| Total allowance for loan losses | \$ 2,596 | \$ 7,796 | \$ 1,269 | \$ 150 | \$ 760 | \$ 12,571 |

The segments of the Company s loan portfolio are disaggregated to a level that allows management to monitor risk and performance. The loan segments used are consistent with the internal reports evaluated by the Company s management and Board of Directors to monitor risk and performance within various segments of its loan portfolio and therefore, no further disaggregation into classes is necessary. The overall risk profile for the commercial loan segment is impacted by non-owner occupied CRE loans, which include loans secured by non-owner occupied nonfarm nonresidential properties, as a meaningful but declining portion of the commercial portfolio is centered in these types of accounts.
The residential mortgage loan segment is comprised of first lien amortizing residential mortgage loans and home equity loans. The consumer loan segment consists primarily of installment loans and overdraft lines of credit connected with customer deposit accounts.

Management evaluates for possible impairment any individual loan in the commercial segment with a loan balance in excess of $\$ 100,000$ that is in nonaccrual status or classified as a Troubled Debt Restructure

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# AMERISERV FINANCIAL, INC. 

# NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS 

## 8. Allowance for Loan Losses

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

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

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

When reviewing an appraisal associated with an existing collateral real estate dependent transaction, the Bank s internal Assigned Risk Department must determine if there have been material changes to the underlying assumptions in the appraisal which affect the original estimate of value. Some of the factors that could cause material changes to reported values include:
the passage of time; the volatility of the local market; the availability of financing; natural disasters; the inventory of competing properties;
new improvements to, or lack of maintenance of, the subject property or competing properties upon physical inspection by the Bank;
changes in underlying economic and market assumptions, such as material changes in current and projected vacancy, absorption rates, capitalization rates, lease terms, rental rates, sales prices, concessions, construction overruns and delays, zoning changes, etc.; and/or
environmental contamination.
The value of the property is adjusted to appropriately reflect the above listed factors and the value is discounted to reflect the value impact of a forced or distressed sale, any outstanding senior liens, any

# AMERISERV FINANCIAL, INC. 

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 8. Allowance for Loan Losses

(continued)
outstanding unpaid real estate taxes, transfer taxes and closing costs that would occur with sale of the real estate. If the
Assigned Risk Department personnel determine that a reasonable value cannot be derived based on available information, a new appraisal is ordered. The determination of the need for a new appraisal, versus completion of a property valuation by the Bank s Assigned Risk Department personnel rests with the Assigned Risk Department and not the originating account officer.

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

June 30, 2013
Impaired
Impaired Loans with Loans with Total Impaired Specific Allowance no Specific Loans

Allowance

| Recorded Related | Recorded | RecordedUnpaid <br> Principal <br> InvestmenAllowance |
| :--- | :--- | :--- |
| Investment | InvestmentBalance |  |


| $\$ 2,187$ | $\$ 747$ | $\$$ | 51 | $\$ 2,238$ | $\$ 2,320$ |
| :--- | :--- | :--- | :--- | :--- | :--- |
|  |  |  | 12 | 12 | 12 |
| $\$ 2,187$ | $\$ 747$ | $\$$ | 63 | $\$ 2,250$ | $\$ 2,332$ |

December 31, 2012

Impaired
$\begin{array}{lll}\text { Impaired Loans with } & \text { Loans with } & \text { Total Impaired } \\ \text { Specific Allowance } & \text { no Specific } & \text { Loans }\end{array}$ Allowance

| R |  | Recorded Investment | Recorded Investme | Unpaid <br> Principa <br> Balance |
| :---: | :---: | :---: | :---: | :---: |
|  | nAllowance |  |  |  |
| \$4,239 | \$ 1,586 | \$ 554 | \$4,793 | \$ 4,850 |
|  |  | 13 | 13 | 13 |
| \$4,239 | \$ 1,586 | \$ 567 | \$4,806 | \$ 4,863 |

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

Average loan balance:
Commercial \$

| Three months |  |
| :--- | :--- |
| ended June 30, | Six months |
| ended June 30, |  |

Commercial loans secured by real estate
Consumer
Average investment in impaired loans
Interest income recognized:
Commercial
\$ \$
\$ \$
\$ \$
Commercial loans secured by real estate
Consumer
Interest income recognized on a cash basis on impaired loans $\quad \$ \quad \$ \quad \$ \quad \$$
Management uses a ten point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized. The first five Pass categories are aggregated, while the Pass-6, Special Mention, Substandard and Doubtful categories are disaggregated to separate pools.

# AMERISERV FINANCIAL, INC. 

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 8. Allowance for Loan Losses

(continued)
The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due, or for which any portion of the loan represents a specific allocation of the allowance for loan losses are placed in Substandard or Doubtful.

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

Loan Review Department is an experienced independent function which reports directly to the Board s Audit Committee. The scope of commercial portfolio coverage by the Loan Review Department is defined and presented to the Audit Committee for approval on an annual basis. The approved scope of coverage for 2013 requires review of a minimum $55 \%$ of the commercial loan portfolio.

In addition to loan monitoring by the account officer and Loan Review Department, the Company also requires presentation of all credits rated Pass-6 with aggregate balances greater than $\$ 1,000,000$, all credits rated Special Mention or Substandard with aggregate balances greater than $\$ 250,000$, and all credits rated Doubtful with aggregate balances greater than $\$ 100,000$ on an individual basis to the Company s Loan Loss Reserve Committee on a quarterly basis. Additionally, the Asset Quality Task Force which is a group comprised of senior level personnel meets bi-weekly to monitor the status of problem loans.

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

June 30, 2013

|  | Pass | Special <br> Mention | Substandard | Doubtful | Total |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Commercial | $\$ 105,664$ | $\$ 7,681$ | $\$ 2,808$ | $\$$ | $\$ 116,153$ |


| Commercial loans secured by real estate | 353,891 | 24,971 | 10,704 | 478 | 390,044 |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Total | $\$ 459,555$ | $\$ 32,652$ | $\$ 13,512$ | $\$ 478$ | $\$ 506,197$ |

December 31, 2012

|  | Pass | Special <br> Mention | Substandard | Doubtful | Total |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
|  |  | $\$ 9,886$ | $\$ 28$ | $\$ 2,908$ | $\$$ |  |
| Commercial | \$ 102,822 |  |  |  |  |  |
| Commercial loans secured by real estate | 343,885 | 20,836 | 17,010 | 1,608 | 383,339 |  |
| Total | $\$ 443,771$ | $\$ 20,864$ | $\$ 19,918$ | $\$ 1,608$ | $\$ 486,161$ |  |

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

# AMERISERV FINANCIAL, INC. 

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 8. Allowance for Loan Losses (continued)

outstanding balance of any consumer loan that exceeds 90 -days past due as to principal and/or interest is charged off. The following tables present the performing and non-performing outstanding balances of the residential and consumer portfolios (in thousands).

Real estate-mortgage
June 30, 2013
Performing Non-Performing
\$220,599 \$ 1,137
Consumer
16,952 12
Total
\$237,551 \$ 1,149

December 31, 2012
Performing Non-Performing
Real estate-mortgage
\$216,393 \$ 1,191
Consumer
17,407 13
Total $\quad \$ 233,800 \quad \$ 1,204$
Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans (in thousands).

June 30, 2013

|  |  |  |  |  |  |  |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
|  |  |  |  |  |  |  |  |  |  |  |

December 31, 2012

|  | Current | $\begin{aligned} & 30 \quad 59 \\ & \text { Days } \\ & \text { Past Due } \end{aligned}$ | $\begin{aligned} & 60 \quad 89 \\ & \text { Days } \\ & \text { Past Due } \end{aligned}$ | 90 Days <br> Past Due | Total Past Due | Total Loans | 90 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  |  |  | Days <br> Past <br> Due <br> and <br> Still <br> Accruing |
| Commercial | \$ 102,775 | \$ | \$ 47 | \$ | \$ 47 | \$ 102,822 | \$ |
| Commercial loans secured by real estate | 379,834 |  | 2,545 | 960 | 3,505 | 383,339 |  |
| Real estate-mortgage | 213,300 | 3,240 | 303 | 741 | 4,284 | 217,584 |  |
| Consumer | 17,371 | 16 | 33 |  | 49 | 17,420 |  |
| Total | \$713,280 | \$3,256 | \$2,928 | \$ 1,701 | \$7,885 | \$721,165 | \$ |

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

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

# AMERISERV FINANCIAL, INC. 

# NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS 

## 8. Allowance for Loan Losses

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

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

Pass rated credits are segregated from Criticized and Classified credits for the application of qualitative factors.
Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL.

## 9. Non-performing Assets Including Troubled Debt Restructurings (TDR)

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

| June 30, | December |
| :--- | :--- |
| 2013 | 31, |
|  | 2012 |

Non-accrual loans
Commercial loans secured by real estate ..... \$2,073 \$4,623
Real estate-mortgage ..... 1,137 1,191
Total ..... 3,210 5,814
Other real estate owned
Commercial loans secured by real estate ..... 1,101 1,101
Real estate-mortgage ..... 540 ..... 127
Total ..... 1,641 ..... 1,228
TDR s not in non-accrual ..... 177 ..... 182Total non-performing assets including TDR\$5,028\$7,224Total non-performing assets as a percent of loans, net of unearnedincome, and other real estate owned0.67 \% 1.00 \%The Company had no loans past due 90 days or more for the periods presented which were accruing interest.

# AMERISERV FINANCIAL, INC. 

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 9. Non-performing Assets Including Troubled Debt Restructurings (TDR) (continued)

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

To be considered a TDR, both of the following criteria must be met:
the borrower must be experiencing financial difficulties; and the Bank, for economic or legal reasons related to the borrower s financial difficulties, grants a concession to the borrower that would not otherwise be considered.

Factors that indicate a borrower is experiencing financial difficulties include, but are not limited to:
the borrower is currently in default on their loan(s); the borrower has filed for bankruptcy; the borrower has insufficient cash flows to service their loan(s); and the borrower is unable to obtain refinancing from other sources at a market rate similar to rates available to a non-troubled debtor.

Factors that indicate that a concession has been granted include, but are not limited to:
the borrower is granted an interest rate reduction to a level below market rates for debt with similar risk; or the borrower is granted a material maturity date extension, or extension of the amortization plan to provide payment relief. For purposes of this policy, a material maturity date extension will generally include any maturity date extension, or the aggregate of multiple consecutive maturity date extensions, that exceed 120 days. A restructuring that results in an insignificant delay in payment, i.e. 120 days or less, is not necessarily a TDR. Insignificant payment delays occur when the amount of the restructured payments subject to the delay is insignificant relative to the unpaid principal or collateral value, and will result in an insignificant shortfall in the originally scheduled contractual amount due, and/or the delay in timing of the restructured payment period is insignificant relative to the frequency of payments, the original maturity or the original amortization.
The determination of whether a restructured loan is a TDR requires consideration of all of the facts and circumstances
surrounding the modification. No single factor is determinative of whether a restructuring is a TDR. An overall general decline in the economy or some deterioration in a borrower $s$ financial condition does not automatically mean that the borrower is experiencing financial difficulty. Accordingly, determination of whether a modification is a TDR involves a large degree of judgment.

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

The Company had no loans modified as TDR s for the three or six month periods ended on June 30, 2013.
The following table details the loans modified as TDRs during both the three and six month periods ended June 30, 2012 (dollars in thousands).

# AMERISERV FINANCIAL, INC. 

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 9. Non-performing Assets Including Troubled Debt Restructurings (TDR) (continued)

$\left.\begin{array}{lccc}\text { Loans in accrual status } & \text { \# of Loans } & \begin{array}{c}\text { Current } \\ \text { Balance }\end{array} & \begin{array}{c}\text { Concession } \\ \text { Granted } \\ \text { Extension of } \\ \text { maturity date }\end{array} \\ \text { Commercial loan secured by real estate } & 2 & \$ 140 & \text { \# of Loans }\end{array} \begin{array}{l}\text { Current } \\ \text { Balance }\end{array} \begin{array}{l}\text { Concession } \\ \text { Granted }\end{array}\right]$ Extension of

In all instances where loans have been modified in troubled debt restructurings the pre- and post-modified balances are the same.

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

The following table presents the recorded investment in loans that were modified as TDR s during each 12-month period prior to the current reporting periods, which begin January 1, 2013 and 2012 (six month periods) and April 1, 2013 and 2012 ( 3 month periods), respectively, and that subsequently defaulted during these reporting periods (dollars in thousands):

|  | Three months ended <br> June 30, <br> 2013 | 2012 |
| :--- | :--- | :--- | :--- | :--- | :--- | | Six months ended |
| :--- |
| June 30, |
| 2013 | 2012

All TDR s are individually evaluated for impairment and a related allowance is recorded, as needed. All TDR s which defaulted in the above table had a related allowance adequate to reserve for anticipated losses.

The Company is unaware of any additional loans which are required to either be charged-off or added to the non-performing asset totals disclosed above. Other real estate owned is recorded at fair value minus estimated costs to sell.

The following table sets forth, for the periods indicated, (1) the gross interest income that would have been recorded if non-accrual loans had been current in accordance with their original terms and had been outstanding throughout the period or since origination if held for part of the period, (2) the amount of interest income actually recorded on such loans, and (3) the net reduction in interest income attributable to such loans (in thousands).

|  | Three months <br> ended June 30, |  | Six months ended <br> June 30, |  |
| :--- | :--- | :--- | :--- | :--- |
|  | 2013 2012 | 2013 | 2012 |  |
| Interest income due in accordance with original terms | $\$ 39$ | $\$ 55$ | $\$ 102$ | $\$ 118$ | 19

## AMERISERV FINANCIAL, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 10. Federal Home Loan Bank Borrowings

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

|  | At June 30, 2013 |  |  |
| :--- | :---: | :---: | :---: |
| Type |  |  | Weighted <br> Average |
|  | Maturing | Amount |  |
| Rate |  |  |  |


| Type | At December 31, 2012 |  |  |
| :---: | :---: | :---: | :---: |
|  | Maturing | Amount | Weighted Average Rate |
| Open Repo Plus | Overnight | \$ 15,660 | 0.25 \% |
| Advances | 2015 | 4,000 | 0.52 |
|  | 2016 | 5,000 | 0.74 |
|  | 2017 | 4,000 | 0.92 |
| Total advances |  | 13,000 | 0.73 |
| Total FHLB borrowings |  | \$ 28,660 | 0.47 \% |

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

## 11. Preferred Stock

SBLF:
On August 11, 2011, pursuant to the Small Business Lending Fund (SBLF), the Company issued and sold to the US Treasury 21,000 shares of its Senior Non-Cumulative Perpetual Preferred Stock, Series E (Series E Preferred Stock)
for the aggregate proceeds of $\$ 21$ million. The SBLF is a voluntary program sponsored by the US Treasury that encourages small business lending by providing capital to qualified community banks at favorable rates. The initial interest rate on the Series E Preferred Stock had been initially set at 5\% per annum and may be decreased to as low as $1 \%$ per annum if growth thresholds were met for qualified outstanding small business loans. The Company used the proceeds from the Series E Preferred Stock issued to the US Treasury to repurchase all 21,000 shares of its outstanding preferred shares previously issued to the US Treasury under the TARP Capital Purchase Program.

The Series E Preferred Stock has an aggregate liquidation preference of approximately $\$ 21$ million and qualifies as
Tier 1 Capital for regulatory purposes. The terms of the Series E Preferred Stock provide for the payment of non-cumulative dividends on a quarterly basis. The dividend rate, as a percentage of the liquidation amount, may fluctuate while the Series E Preferred Stock is outstanding based upon changes in the level of qualified small business lending ( QSBL ) by the Bank from its average level of QSBL at each of the four quarter ends leading up to June 30, 2010 (the Baseline ) as follows:

DIVIDEND PERIOD ANNUALIZED
BEGINNING ENDING
August 11, 2011
January 1, 2012
January 1, 2014
20

# AMERISERV FINANCIAL, INC. 

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

11. Preferred Stock (continued)

DIVIDEND PERIOD ANNUALIZED<br>BEGINNING ENDING<br>February 8, 2016<br>Redemption

ANNUALIZED<br>DIVIDEND RATE<br>$9.0 \%^{(2)}$

(1) Between January 1, 2014 and February 7, 2016, the dividend rate will be fixed at a rate in such range based upon ${ }^{(1)}$ the level of percentage change in QSBL between September 30, 2013 and the Baseline.
(2) Beginning on February 8, 2016, the dividend rate will be fixed at nine percent ( $9 \%$ ) per annum.

In addition to the applicable dividend rates described above, beginning on January 1, 2014 and on all dividend payment dates thereafter ending on April 1, 2016, if we fail to increase our level of QSBL compared to the Baseline, we will be required to pay a quarterly lending incentive fee of $0.5 \%$ of the liquidation value. As of June 30, 2013, the Company had increased its QSBL to a level that reduced the dividend rate to $1 \%$. This $1 \%$ rate will continue at least through the fourth quarter of 2013.

As long as shares of Series E Preferred Stock remain outstanding, we may not pay dividends to our common shareholders (nor may we repurchase or redeem any shares of our common stock) during any quarter in which we fail to declare and pay dividends on the Series E Preferred Stock and for the next three quarters following such failure. In addition, under the terms of the Series E Preferred Stock, we may only declare and pay dividends on our common stock (or repurchase shares of our common stock), if, after payment of such dividend, the dollar amount of our Tier 1 capital would be at least ninety percent ( $90 \%$ ) of Tier 1 capital as of June 30, 2011, excluding any charge-offs and
redemptions of the Series E Preferred Stock (the Tier 1 Dividend Threshold ). The Tier 1 Dividend Threshold is subject to reduction, beginning January 1, 2014, based upon the extent by which, if at all, the QSBL at September 30, 2013 has increased over the Baseline.

We may redeem the Series E Preferred Stock at any time at our option, at a redemption price of $100 \%$ of the liquidation amount plus accrued but unpaid dividends, subject to the approval of our federal banking regulator.

## 12. Accumulated Other Comprehensive Loss

The following table presents the changes in each component of accumulated other comprehensive loss, net of tax, for the three and six months ended June 30, 2013 (in thousands):

| Net Unrealized | Defined | Total |
| :--- | :--- | :--- |
| Gains and | Benefit |  |
| Losses on | Pension |  |


| Balance at April 1, 2013 | $\$ 3,774$ | $\$(9,197$ | $)$ | $\$(5,423)$ |
| :--- | :---: | :---: | :---: | :---: |
| Other comprehensive loss before reclassifications | $(2,060$ | $)$ |  | $(2,060)$ |
| Amounts reclassified from accumulated other |  | 220 | 220 |  |
| comprehensive loss |  |  |  |  |
| Net current period other comprehensive income (loss) <br> Balance at June 30, 2013 | $(2,060$ | $)$ | 220 | $(1,840)$ |
| 1,714 | $\$(8,977$ | $\$(7,263)$ |  |  |

(1) Amounts in parentheses indicate debits.

# AMERISERV FINANCIAL, INC. 

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 12. Accumulated Other Comprehensive Loss

(continued)

(1)

Amounts in parentheses indicate debits.
The following table presents the amounts reclassified out of each component of accumulated other comprehensive loss for the three and six months ended June 30, 2013 (in thousands):

Three months ended June 30, 2013
Details about accumulated other comprehensive loss components

Amortization of defined benefit items ${ }^{(2)}$

Estimated net loss
Prior service cost
Transition asset

Total reclassifications for the period

| Amount reclassified from accumulated other comprehensive $\operatorname{loss}^{(1)}$ |  |  | Affected line item in the statement of operations |
| :---: | :---: | :---: | :---: |
| \$ | 341 |  | Salaries and employee benefits |
|  | (5 | ) | Salaries and employee benefits |
|  | (2 | ) | Salaries and employee benefits |
|  | 334 |  | Total before tax |
|  | (114 | ) | Provision for income tax expense |
| \$ | 220 |  | Net of tax |
|  | 220 |  | Net of tax |

Amounts in parentheses indicate credits.

These accumulated other comprehensive loss components are included in the computation of net periodic benefit cost (see Note 16 for additional details).

Six months ended June 30, 2013
Details about accumulated other comprehensive loss components

Unrealized gains and losses on sale of securities

Amount
reclassified from accumulated other comprehensive loss ${ }^{(1)}$

| \$ | (71 | ) | Net realized gains on investmen securities AFS |
| :---: | :---: | :---: | :---: |
|  | (71 | ) | Total before tax |
|  | 24 |  | Provision for income tax expense |
| \$ | (47 | ) | Net of tax |
| \$ | 682 |  | Salaries and employee benefits |
|  | (10 | ) | Salaries and employee benefits |
|  | (4 | ) | Salaries and employee benefits |
|  | 668 |  | Total before tax |
|  | (228 | ) | Provision for income tax expense |
| \$ | 440 |  | Net of tax |
|  | 393 |  | Net of tax |

(2) These accumulated other comprehensive loss components are included in the computation of net periodic benefit cost (see Note 16 for additional details).

# AMERISERV FINANCIAL, INC. 

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 13. Regulatory Capital

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

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk-weighted assets, and of

Tier 1 capital to average assets. As of June 30, 2013, the Federal Reserve categorized the Company as Well Capitalized under the regulatory framework for prompt corrective action. The Company believes that no conditions or events have occurred that would change this conclusion. To be categorized as well capitalized, the Company must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. Additionally, while not a regulatory capital ratio, the Company s tangible common equity ratio was $7.47 \%$ at June 30, 2013 (in thousands, except ratios).

At June 30, 2013

| Actual |  | $\begin{array}{l}\text { For Capital } \\ \text { Adequacy } \\ \text { Purposes }\end{array}$ | $\begin{array}{l}\text { To Be Well } \\ \text { Capitalized Under } \\ \text { Prompt Corrective } \\ \text { Action Provisions }\end{array}$ |  |  |  |  |
| :--- | :---: | :--- | :--- | :--- | :--- | :---: | :---: |
| Amount | Ratio | $\begin{array}{l}\text { Amount }\end{array}$ |  | Ratio | $\begin{array}{l}\text { Amount }\end{array}$ |  | Ratio |$\}$| $\$ 124,472$ | $15.48 \%$ | $\$ 64,310$ | $8.00 \%$ | $\$ 80,387$ | $10.00 \%$ |
| :--- | :--- | :--- | :--- | :--- | :--- |
| 101,767 | 12.78 | 63,680 | 8.00 | 79,600 | 10.00 |
| 114,401 | 14.23 | 32,155 | 4.00 | 48,232 | 6.00 |
| 91,794 | 11.53 | 31,840 | 4.00 | 47,760 | 6.00 |
| 114,401 | 11.52 | 39,717 | 4.00 | 49,646 | 5.00 |
| 91,794 | 9.49 | 38,705 | 4.00 | 48,381 | 5.00 |

At December 31, 2012
Actual

|  | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| Total Capital (To Risk Weighted Assets) | $\$ 122,583$ | $15.92 \%$ | $\$ 61,588$ | $8.00 \%$ | $\$ 76,985$ | $10.00 \%$ |
| Consolidated | 101,786 | 13.34 | 61,060 | 8.00 | 76,325 | 10.00 |
| AmeriServ Financial Bank | 112,916 | 14.67 | 30,794 | 4.00 | 46,191 | 6.00 |
| Tier 1 Capital (To Risk Weighted Assets) | 92,200 | 12.08 | 30,530 | 4.00 | 45,795 | 6.00 |
| Consolidated | 112,916 | 11.44 | 39,474 | 4.00 | 49,343 | 5.00 |
| AmeriServ Financial Bank | 92,200 | 9.55 | 38,616 | 4.00 | 48,269 | 5.00 |

On July 2, 2013, the Board of Governors of the Federal Reserve System approved final rules that substantially amend the regulatory risk-based capital rules applicable to the Company and the Bank. The final rules implement the Basel

III regulatory capital reforms, as well as certain changes required by the Dodd-Frank Act, which will require institutions to, among other things, have more capital and a higher quality

# AMERISERV FINANCIAL, INC. 

# NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS 

## 13. Regulatory Capital (continued)

of capital by increasing the minimum regulatory capital ratios, and requiring capital buffers. The new rules become effective for the Company on January 1, 2015, with an implementation period that stretches to 2019.

## 14. Segment Results

The financial performance of the Company is also monitored by an internal funds transfer pricing profitability measurement system which produces line of business results and key performance measures. The Company s major business units include retail banking, commercial lending, trust, and investment/parent. The reported results reflect the underlying economics of the business segments. Expenses for centrally provided services are allocated based upon the cost and estimated usage of those services. The businesses are match-funded and interest rate risk is centrally managed and accounted for within the investment/parent business segment. The key performance measure the Company focuses on for each business segment is net income contribution.

Retail banking includes the deposit-gathering branch franchise and lending to both individuals and small businesses. Lending activities include residential mortgage loans, direct consumer loans, and small business commercial loans. Commercial banking to businesses includes commercial loans, and commercial real-estate loans. The trust segment contains our wealth management businesses which include the Trust Company, West Chester Capital Advisors, our registered investment advisory firm and financial services. Wealth management includes personal trust products and services such as personal portfolio investment management, estate planning and administration, custodial services and pre-need trusts. Also, institutional trust products and services such as $401(\mathrm{k})$ plans, defined benefit and defined contribution employee benefit plans, and individual retirement accounts are included in this segment. Financial services include the sale of mutual funds, annuities, and insurance products. The wealth management businesses also includes the union collective investment funds, namely the ERECT and BUILD funds which are designed to use union pension dollars in construction projects that utilize union labor. The investment/parent includes the net results of investment securities and borrowing activities, general corporate expenses not allocated to the business segments, interest expense on guaranteed junior subordinated deferrable interest debentures, and centralized interest rate risk management. Inter-segment revenues were not material.

The contribution of the major business segments to the Consolidated Results of Operations for the three and six months ended June 30, 2013 and 2012 were as follows (in thousands):

| Three months ended | Six months ended |  |  |
| :--- | :--- | :--- | :--- |
| June 30, 2013 | June 30, 2013 | June 30, 2013 |  |
| Total | Net income | Total | Net income |
| (lovenue | (loss) | revenue | (loss) | assets

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| Retail banking | $\$ 6,761$ | $\$ 787$ | $\$ 13,510$ | $\$ 1,610$ | $\$ 334,239$ |
| :--- | :---: | :--- | :---: | :---: | :---: |
| Commercial banking | 3,981 | 1,008 | 7,868 | 2,053 | 520,104 |
| Trust | 2,183 | 330 | 4,168 | 506 | 4,520 |
| Investment/Parent | $(829$ | $(1,055$ | $)$ | $(1,592)$ | $(2,043)$ |
| Total | $\$ 12,096$ | $\$ 1,070$ | $\$ 23,954$ | $\$ 2,126$ | $\$ 1,025,084$ |

Retail banking
Commercial banking
Trust
Investment/Parent
Total

| Three months ended <br> June 30, 2012 | Six months ended <br> Tune 30, 2012 |  | June 30, 2012 |  |
| :--- | :--- | :--- | :--- | :--- |
| Total | Net income | Total | Net income | Total |
| revenue | (loss) | revenue | (loss) | assets |
| $\$ 6,697$ | $\$ 786$ | $\$ 13,400$ | $\$ 1,627$ | $\$ 336,726$ |
| 3,650 | 1,301 | 7,244 | 2,547 | 464,209 |
| 1,975 | 246 | 3,952 | 498 | 4,376 |
| $(668$ | $(901$ | $(1,210)$ | $(1,675)$ | 191,791 |
| $\$ 11,654$ | $\$ 1,432$ | $\$ 23,386$ | $\$ 2,997$ | $\$ 997,102$ |

# AMERISERV FINANCIAL, INC. 

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 15. Commitments and Contingent Liabilities

The Company had various outstanding commitments to extend credit approximating $\$ 141.5$ million and standby
letters of credit of $\$ 13.3$ million as of June 30, 2013. The Company s exposure to credit loss in the event of nonperformance by the other party to these commitments to extend credit and standby letters of credit is represented by their contractual amounts. The Bank uses the same credit and collateral policies in making commitments and conditional obligations as for all other lending.

Additionally, the Company is also subject to a number of asserted and unasserted potential claims encountered in the normal course of business. In the opinion of the Company, neither the resolution of these claims nor the funding of these credit commitments will have a material adverse effect on the Company s consolidated financial position, results of operation or cash flows.

## 16. Pension Benefits

The Company has a noncontributory defined benefit pension plan covering certain employees who work at least 1,000 hours per year. Effective January 1, 2013, the Company amended the defined benefit pension plan to provide that employees hired on or after that date are not eligible to participate. Instead such employees are eligible to participate in a qualified $401(\mathrm{k})$ retirement plan. The participants shall have a vested interest in their accrued benefit after five full years of service. The benefits of the plan are based upon the employee s years of service and average annual earnings
for the highest five consecutive calendar years during the final ten year period of employment. Plan assets are primarily debt securities (including US Treasury and Agency securities, corporate notes and bonds), listed common stocks (including shares of AmeriServ Financial, Inc. common stock which is limited to $10 \%$ of the plan sassets), mutual funds, and short-term cash equivalent instruments. The net periodic pension cost for the three and six months ended June 30, 2013 and 2012 were as follows (in thousands):

|  | Three months ended <br> June 30, <br> 2013 | 2012 | Six months ended <br> June 30, <br> 2013 | 2012 |
| :--- | :---: | :--- | :--- | :--- | :--- |

The higher pension expense in 2013 reflects the negative impact that the low interest rate environment is having on the discount rate used to calculate the plan liabilities. This increasing pension cost was a key factor causing the Company to implement a soft freeze of its defined benefit pension plan to provide that non-union employees hired on or after January 1, 2013 are not eligible to participate. Instead, such employees are eligible to participate in a qualified 401(k) plan.

## 17. Disclosures About Fair Value Measurements

The following disclosures establish a hierarchal disclosure framework associated with the level of pricing observability utilized in measuring assets and liabilities at fair value. The three broad levels defined within this hierarchy are as follows:

Level I: Quoted prices are available in active markets for identical assets or liabilities as of the reported date.
25

# AMERISERV FINANCIAL, INC. 

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 17. Disclosures About Fair Value Measurements

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

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

## Assets and Liability Measured on a Recurring Basis

Securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quoted market spreads, cash flows, the US Treasury yield curve, live trading
levels, trade execution data, market consensus prepayment speeds, credit information and the bond s terms and conditions, among other things.

The fair value of the swap asset and liability is based on an external derivative valuation model using data inputs as of the valuation date and classified Level 2.

The following tables present the assets reported on the consolidated balance sheets at their fair value as of June 30, 2013 and December 31, 2012, by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

Assets and liability measured at fair value on a recurring basis are summarized below (in thousands):

[^0]

| US Agency securities | $\$ 5,911$ | $\$$ | $\$ 5,911$ |
| :--- | :--- | :--- | :--- |
| US Agency mortgage-backed securities | 137,735 | $\$$ |  |
| Corporate bonds | 7,892 | 137,735 |  |
| Fair value of swap asset | 164 | 1692 |  |
| Fair value of swap liability | 164 | 164 |  |

## Assets Measured on a Non-recurring Basis

Loans considered impaired are loans for which, based on current information and events, it is probable that the creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. As detailed in the allowance for loan loss footnote, impaired loans are reported at fair value of the underlying collateral if the repayment is expected solely from the collateral. Collateral values are estimated using Level 3 inputs based on observable market data which at times are discounted. At June 30, 2013, impaired loans with a carrying value of $\$ 2.3$ million were reduced by a specific valuation allowance totaling

# AMERISERV FINANCIAL, INC. 

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 17. Disclosures About Fair Value Measurements

(continued)
$\$ 747,000$ resulting in a net fair value of $\$ 1.5$ million. At December 31, 2012, impaired loans with a carrying value of $\$ 4.8$ million were reduced by a specific valuation allowance totaling $\$ 1.6$ million resulting in a net fair value of $\$ 3.2$ million.

Other real estate owned (OREO) is measured at fair value based on appraisals, less cost to sell at the date of foreclosure. Valuations are periodically performed by management. Income and expenses associated with managing OREO and changes in valuation allowance are included in the net expenses from OREO.

Assets measured at fair value on a non-recurring basis are summarized below (in thousands):

|  | Fair Value Measurements at June 30, 2013 Using |  |  |  |
| :--- | :--- | :--- | :--- | :--- |
| Impaired loans | Total | (Level 1) | (Level 2) | (Level 3) |
| Other real estate owned | $\$ 1,503$ | $\$$ | $\$$ | $\$ 1,503$ |
|  | 1,641 |  |  | 1,641 |

Fair Value Measurements at December 31, 2012
Using
Total (Level 1) (Level 2) (Level 3)
Impaired loans
\$ 3,220
1,228
\$ 3,220
Other real estate owned
1,228

June 30, 2013

Impaired loans
\$1,503
Other real estate owned
1,641

| Valuation | Unobservable |
| :--- | :--- |
| Techniques | Input |

Range
Quantitative Information About Level 3 Fair Value Measurements Fair $\begin{array}{ll}\text { Value } & \text { Valuation } \\ \text { Estimate } & \text { Techniques }\end{array}$ Input

Appraisal of
Appraisal adjustments ${ }^{(2)} \quad 0 \%$ to $35 \%$ collateral ${ }^{(1)}$

Liquidation expenses ${ }^{(2)} \quad 1 \%$ to $15 \%$
Appraisal of Appraisal adjustments ${ }^{(2)} \quad 0 \%$ to $35 \%$
collateral ${ }^{(1),(3)} \quad$ Liquidation expenses ${ }^{(2)} \quad 1 \%$ to $20 \%$

December 31, 2012
Quantitative Information About Level 3 Fair Value Measurements
Fair Valuation Unobservable Input Range
Value Techniques

Estimate

| Impaired loans | $\$ 3,220$ | Appraisal of <br> collateral $^{(1)}$ | Appraisal adjustments ${ }^{(2)}$ | Liquidation to 35penses |
| :--- | :--- | :--- | :--- | :--- |
| Other real estate owned |  |  |  |  |

(1) Fair Value is generally determined through independent appraisals of the underlying collateral, which generally ${ }^{1}$ include various level 3 inputs which are not identifiable.
(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses.
(3) Includes qualitative adjustments by management and estimated liquidation expenses. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

For the Company, as for most financial institutions, approximately $90 \%$ of its assets and liabilities are considered financial instruments. Many of the Company s financial instruments, however, lack an available trading market characterized by a willing buyer and willing seller engaging in an exchange transaction. Therefore, significant estimates and present value calculations were used by the Company for the purpose of this disclosure.

Fair values have been determined by the Company using independent third party valuations that use the best available data (Level 2) and an estimation methodology (Level 3) the Company believes is suitable for each category of financial instruments. Management believes that cash, cash equivalents, and loans and deposits with floating interest rates have estimated fair values which approximate the recorded book balances.

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# NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS 

## 17. Disclosures About Fair Value Measurements <br> (continued)

The estimation methodologies used, the estimated fair values based on US GAAP measurements, and recorded book balances at June 30, 2013 and December 31, 2012, were as follows (in thousands):

FINANCIAL ASSETS:
Cash and cash equivalents
Investment securities AFS
Investment securities HTM
Regulatory stock
Loans held for sale
Loans, net of allowance for loan loss and unearned income
Accrued income receivable
Bank owned life insurance
Fair value swap asset
FINANCIAL LIABILITIES:
Deposits with no stated maturities
Deposits with stated maturities
Short-term borrowings
All other borrowings
Accrued interest payable
Fair value swap liability

FINANCIAL ASSETS:
Cash and cash equivalents
Investment securities AFS
Investment securities HTM
Regulatory stock
Loans held for sale

| June 30, 2013 <br> Carrying <br> Value | Fair <br> Value | (Level 1) |  |  |
| :--- | :--- | :--- | :--- | :--- |
| (Level 2) |  |  |  |  | (Level 3)


| December 31, 2012 <br> Carrying <br> Value | Fair <br> Value | (Level 1) |  |  |
| :--- | :--- | :--- | :--- | :--- |
|  |  |  |  |  |
| $\$ 26,820$ | $\$ 26,820$ | $\$ 26,820$ | $\$$ | $\$$ |
| 151,538 | 151,538 |  | 151,538 |  |
| 13,723 | 14,266 |  | 11,321 | 2,945 |
| 6,304 | 6,304 | 6,304 |  |  |
| 10,576 | 10,722 | 10,722 |  |  |
| 708,594 | 716,756 |  |  | 716,756 |

Loans, net of allowance for loan loss and unearned income
Accrued income receivable
Bank owned life insurance
Fair value swap asset
FINANCIAL LIABILITIES:
Deposits with no stated maturities
Deposits with stated maturities
Short-term borrowings
All other borrowings
Accrued interest payable
Fair value swap liability

| 2,960 | 2,960 | 2,960 |  |  |
| :--- | :--- | :--- | :--- | :--- |
| 36,214 | 36,214 | 36,214 |  |  |
| 164 | 164 |  | 164 |  |
|  |  |  |  | $\$$ |
| $\$ 520,002$ | $\$ 520,002$ | $\$ 520,002$ | $\$$ | 320,930 |
| 315,732 | 320,930 |  |  |  |
| 15,660 | 15,660 | 15,660 |  | 30,442 |
| 26,085 | 30,442 |  |  |  |
| 2,083 | 2,083 | 2,083 |  |  |
| 164 | 164 |  | 164 |  |

# AMERISERV FINANCIAL, INC. 

# NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS 

## 17. Disclosures About Fair Value Measurements

(continued)


#### Abstract

The fair value of cash and cash equivalents, regulatory stock, accrued income receivable, short-term borrowings, and accrued interest payable are equal to the current carrying value.


The fair value of investment securities is equal to the available quoted market price for similar securities. The fair value measurements consider observable data that may include dealer quoted market spreads, cash flows, the US

Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond s terms and conditions, among other things. The Level 3 security is valued by discounted cash flows using the US Treasury rate for the remaining term of the security.

Loans held for sale are priced individually at market rates on the day that the loan is locked for commitment with an investor. All loans in the held for sale account conform to Fannie Mae underwriting guidelines, with the specific intent of the loan being purchased by an investor at the predetermined rate structure. Loans in the held for sale account have specific delivery dates that must be executed to protect the pricing commitment (typically a 30,45 , or 60 day lock period).

The net loan portfolio has been valued using a present value discounted cash flow. The discount rate used in these calculations is based upon the treasury yield curve adjusted for non-interest operating costs, credit loss, current market prices and assumed prepayment risk.

The fair value of bank owned life insurance is based upon the cash surrender value of the underlying policies and matches the book value.

Deposits with stated maturities have been valued using a present value discounted cash flow with a discount rate approximating current market for similar assets and liabilities. Deposits with no stated maturities have an estimated fair value equal to both the amount payable on demand and the recorded book balance.

The fair value of all other borrowings is based on the discounted value of contractual cash flows. The discount rates are estimated using rates currently offered for similar instruments with similar remaining maturities.

The fair values of the swaps used for interest rate risk management represents the amount the Company would have expected to receive or pay to terminate such agreements.

Changes in assumptions or estimation methodologies may have a material effect on these estimated fair values. The Company s remaining assets and liabilities which are not considered financial instruments have not been valued differently than has been customary under historical cost accounting.

# Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS ( M.D.\& 

 A.)
## 2013 SECOND QUARTER SUMMARY OVERVIEW

For the second quarter of 2013, the Company had $\$ 1,018,000$ net income available to common shareholders, or $\$ 0.05$ per share. This performance equaled the per share earnings of the first quarter of 2013, but fell $\$ 0.01$ below the per share earnings of the second quarter of 2012. Both of these quarters earnings were aided by negative provisions from the loan loss reserve, while in this most recent quarter AmeriServ made a positive contribution of $\$ 150,000$ to the allowance for loan losses.

It is well known that most community financial institutions such as AmeriServ generate the bulk of their operating revenue by the lending of money. In this second quarter of 2013 , almost $63 \%$ of AmeriServ s total revenue came from this lending of money to businesses and consumers as AmeriServ emphasized loan growth. But we have learned in times of economic weakness such as the U.S. has experienced since 2008, it is important for a community bank to maintain strong loan loss reserves to protect the franchise. AmeriServ stypical small business borrowers are often quite successful, but a weak economy such as exists today may cause them financial stress. Therefore a strong loan
loss reserve is wise. As of June 30, 2013, AmeriServ s allowance for loan losses provided a coverage ratio of non-performing loans of $329 \%$, well above banking industry norms. This is a franchise strength.

Through the first six months of 2013, AmeriServ earned net income available to common shareholders of $\$ 2,022,000$ or $\$ 0.11$ cents per share. This compares with $\$ 2,472,000$ or $\$ 0.12$ per share in the first six months of 2012. We were pleased that due to the continuing extensive prospecting by our lending staff loans outstanding, at quarter end, was above any previous quarter since the AmeriServ name was adopted in the year 2000. This strong loan growth also enabled AmeriServ to continue to obtain capital from the US Treasury at $1 \%$, the lowest rate permitted under the Small Business Lending Fund.

The Federal Reserve is continuing the Zero Interest Rate program that it began in 2009. This program punishes pension funds, thrifty savers and community banks. Therefore, in such times, AmeriServ turns to its fee generating units to generate strong revenue flows. During the second quarter and the first six months of 2013 the mortgage origination function provided a strong continuing stream of fee revenues. Additionally, we are pleased that AmeriServ has been selected as the favored mortgage originations bank by the Pennsylvania State Education Association for its 190,000 members throughout the state. We believe this is an excellent opportunity for AmeriServ to exhibit its abilities over a much broader area than our core markets provide and at the same time to grow fees.

AmeriServ Trust \& Financial Services Company also continues to provide strong fee flow. Its retirement services division and financial services division are both reaching a high level of fee generation. The Trust Company recorded a very profitable second quarter and for the first six months of 2013 is already even with its outstanding performance for the first six months of 2012.

Another gratifying event of the second quarter was the decision of the Board of Directors to initiate a quarterly cash dividend. The payment of $\$ 0.01$ per share was delivered to shareholders in May. This action recognizes the importance of a reliable cash dividend to many of our shareholders. Note that on July 18, 2013, the Board of Directors again declared a $\$ 0.01$ per share quarterly common stock cash dividend that will be paid August 19, 2013, to shareholders of record on August 5, 2013. The month of May also saw AmeriServ execute another stock repurchase
program. This reduction of the number of outstanding AmeriServ shares by $2 \%$ is quite positive to the book value of every share.

The media emphasis of late has been on the easy money program of the Federal Reserve. Apparently some investors have adopted investment strategies for which easy money is the essential ingredient. Just the mention of the Fed bringing that program to an end has sent some market indexes tumbling. Rest assured AmeriServ continues to plot a course based on a conservative balance sheet, strong capital, deep liquidity and careful calculations of its very necessary loan loss reserves. We believe that this is the way to build a strong franchise and to keep it strong. Now that AmeriServ has become a dividend payer again we believe that this core strength will enable us to continue to pursue the tried and true ways to generate earnings rather than falling into the foolish trap of trying to play the markets.

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# THREE MONTHS ENDED JUNE 30, 2013 VS. THREE MONTHS ENDED JUNE 30, 2012 

 PERFORMANCE OVERVIEW
#### Abstract

The following table summarizes some of the Company's key performance indicators (in thousands, except per share and ratios).


|  | Three <br> months | Three months <br> ended June <br> ended June |
| :--- | :--- | :--- |
|  | 30, | 30,2012 |

The Company reported second quarter 2013 net income of $\$ 1,070,000$ and net income available to common shareholders of $\$ 1,018,000$ or $\$ 0.05$ per diluted common share. While net income decreased by $25.3 \%$ when compared to the second quarter of 2012, earnings per share declined by a lesser amount of $16.7 \%$ due to a lower dividend paid on the SBLF preferred stock and fewer common shares outstanding due to success of the Company s recently completed common stock repurchase program. The Company has been successful in growing commercial loans in categories that qualify for the SBLF. As such, the Company continues to pay the lowest preferred dividend rate of $1 \%$ available under the SBLF program. This $1 \%$ dividend rate is expected to continue throughout 2013 which saves the Company approximately $\$ 200,000$ in preferred dividends on a quarterly basis. The Company s 2013 second
quarter net income was also negatively impacted by an increased provision for loan losses and a higher level of non-interest expense. These negative items were partially offset by increased revenue in both net interest income and non-interest income and reduced income tax expense in the second quarter of 2013.

## NET INTEREST INCOME AND MARGIN

The Company's net interest income represents the amount by which interest income on average earning assets exceeds interest paid on average interest bearing liabilities. Net interest income is a primary source of the Company's earnings, and it is affected by interest rate fluctuations as well as changes in the amount and mix of average earning assets and average interest bearing liabilities. The following table compares the Company's net interest income performance for the second quarter of 2013 to the second quarter of 2012 (in thousands, except percentages):

|  | Three months ended June 30, 2013 | Three months ended June 30, 2012 | \$ Change |  | \% Change |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Interest income | \$ 9,627 | \$ 9,885 | \$ (258 | ) | (2.6 | )\% |
| Interest expense | 1,606 | 1,964 | (358 | ) | (18.2 | ) |
| Net interest income | \$ 8,021 | \$ 7,921 | \$ 100 |  | 1.3 |  |


| Net interest margin | 3.50 | $\%$ | 3.59 | $\%$ | $(0.09$ | $)$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| N/M |  |  |  |  |  |  |

N/M not meaningful
The Company s net interest income in the second quarter of 2013 increased by $\$ 100,000$ or $1.3 \%$ when compared to the second quarter of 2012. The Company s second quarter 2013 net interest margin of $3.50 \%$ was nine basis points
lower than the net interest margin of $3.59 \%$ for the second quarter of 2012 . The lower net interest margin demonstrates the impact of Federal Reserve low interest rate policies which have pressured interest revenue. The Company has been able to mitigate this net interest margin pressure and modestly increase net interest income by reducing its cost of funds and growing its earning assets, particularly loans. Specifically, total loans have averaged $\$ 728$ million in the second quarter of 2013, which is $\$ 59$ million or $8.8 \%$ higher than the $\$ 669$ million average in the second quarter of 2012. This loan growth reflects the successful results of the Company s more intensive sales calling efforts with an emphasis on generating commercial loans and owner occupied commercial real estate loans which qualify as SBLF loans, particularly through its loan production offices.

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Despite this solid growth in loans, total interest revenue dropped by $\$ 258,000$ between years and reflects the lower interest rate environment. Interest revenue has also been negatively impacted by premium amortization on mortgage backed securities due to accelerated mortgage prepayment speeds and lower overall total investment security balances.

However, careful management of funding costs has allowed the Company to mitigate this drop in interest revenue during the past year. Specifically, total interest expense for the second quarter of 2013 declined by $\$ 358,000$ from the second quarter of 2012 due to the Company s proactive efforts to reduce deposit costs. The Company continues to have ample liquidity as evidenced by a loan to deposit ratio of $88.6 \%$ at June 30, 2013.

The table that follows provides an analysis of net interest income on a tax-equivalent basis for the three month periods ended June 30, 2013 and June 30, 2012 setting forth (i) average assets, liabilities, and stockholders' equity, (ii) interest income earned on interest earning assets and interest expense paid on interest bearing liabilities, (iii) average yields earned on interest earning assets and average rates paid on interest bearing liabilities, (iv) the Company s interest rate spread (the difference between the average yield earned on interest earning assets and the average rate paid on interest bearing liabilities), and (v) the Company s net interest margin (net interest income as a percentage of average total interest earning assets). For purposes of these tables, loan balances do include non-accrual loans, and interest income on loans includes loan fees or amortization of such fees which have been deferred, as well as interest recorded on certain non-accrual loans as cash is received. Additionally, a tax rate of $34 \%$ is used to compute tax-equivalent yields.

Three months ended June 30 (In thousands, except percentages)

|  | 2013 | 2012 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Average Balance | Interest <br> Income/ <br> Expense | Yield/ <br> Rate | Average Balance | Interest <br> Income/ <br> Expense | Yield/ <br> Rate |
| Interest earning assets: |  |  |  |  |  |  |
| Loans and loans held for sale, net of unearned income | \$728,189 | \$8,596 | 4.69\% | \$669,307 | \$ 8,558 | 5.08 \% |
| Interest bearing deposits | 9,511 | 3 | 0.13 | 7,359 | 5 | 0.27 |
| Short-term investment in money market funds | 5,702 | 4 | 0.40 | 13,775 | 7 | 0.20 |
| Investment securities AFS | 151,609 | 907 | 2.39 | 176,258 | 1,210 | 2.75 |
| Investment securities HTM | 17,873 | 123 | 2.75 | 13,676 | 111 | 3.25 |
| Total investment securities | 169,482 | 1,030 | 2.43 | 189,934 | 1,321 | 2.78 |
| Total interest earning assets/interest income | 912,884 | 9,633 | 4.21 | 880,375 | 9,891 | 4.49 |
| Non-interest earning assets: |  |  |  |  |  |  |
| Cash and due from banks | 16,470 |  |  | 16,072 |  |  |
| Premises and equipment | 12,799 |  |  | 10,928 |  |  |
| Other assets | 75,924 |  |  | 81,557 |  |  |
| Allowance for loan losses | (10,989 ) |  |  | $(13,839)$ |  |  |
| TOTAL ASSETS | \$1,007,088 |  |  | \$975,093 |  |  |
| Interest bearing liabilities: |  |  |  |  |  |  |
| Interest bearing deposits: |  |  |  |  |  |  |
| Interest bearing demand | \$74,721 | \$ 35 | 0.19\% | \$59,441 | \$ 28 | 0.19\% |
| Savings | 88,919 | 35 | 0.16 | 85,406 | 50 | 0.25 |
| Money markets | 208,050 | 180 | 0.36 | 206,443 | 225 | 0.44 |
| Other time | 309,318 | 1,038 | 1.35 | 334,128 | 1,365 | 1.64 |


| Total interest bearing deposits | 681,008 | 1,288 | 0.76 | 685,418 | 1,668 | 0.98 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Short-term borrowings: <br> Other short-term borrowings | 12,067 | 8 | 0.27 | 440 |  | 0.25 |

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|  | 2013 |  |  | 2012 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Average Balance | Interest Income/ Expense | Yield/ <br> Rate | Average Balance | Interest Income/ <br> Expense | Yield/ <br> Rate |
| Advances from Federal Home Loan Bank | 16,000 | 30 | 0.76 | 4,140 | 16 | 1.59 |
| Guaranteed junior subordinated deferrable interest debentures | 13,085 | 280 | 8.57 | 13,085 | 280 | 8.57 |
| Total interest bearing liabilities/interest expense | 722,160 | 1,606 | 0.89 | 703,083 | 1,964 | 1.12 |
| Non-interest bearing liabilities: |  |  |  |  |  |  |
| Demand deposits | 160,773 |  |  | 145,738 |  |  |
| Other liabilities | 12,860 |  |  | 15,375 |  |  |
| Shareholders' equity | 111,295 |  |  | 110,897 |  |  |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$1,007,088 |  |  | \$975,093 |  |  |
| Interest rate spread |  |  | 3.32 |  |  | 3.37 |
| Net interest income/Net interest margin |  | 8,027 | 3.50\% |  | 7,927 | 3.59 \% |
| Tax-equivalent adjustment |  | (6) |  |  | (6) |  |
| Net Interest Income |  | \$8,021 |  |  | \$7,921 |  |

The Company recorded a $\$ 150,000$ provision for loan losses in the second quarter of 2013 compared to a $\$ 500,000$ negative provision recorded in the second quarter of 2012. Overall, sustained improvements in asset quality evidenced by low levels of non-performing assets and classified loans has allowed the Company to record a modest loan loss provision in the second quarter of 2013 while still maintaining strong coverage ratios. At June 30, 2013, non-performing assets totaled $\$ 5.0$ million or $0.67 \%$ of total loans which is down by $\$ 2.2$ million from December 31,

2012, but is comparable with the level they have operated at in five of the last six quarters. The Company also experienced modest net loan recoveries in both the second quarter of 2013 and 2012. When determining the provision for loan losses, the Company considers a number of factors some of which include periodic credit reviews, non-performing assets, loan delinquency and charge-off trends, concentrations of credit, loan volume trends and broader local and national economic trends. In summary, the allowance for loan losses provided $329 \%$ coverage of non-performing loans at June 30, 2013, compared to 210\% of non-performing loans at December 31, 2012.

## NON-INTEREST INCOME

The Company s growth in non-interest revenue has been a financial performance highlight in 2013. Non-interest income for the second quarter of 2013 totaled $\$ 4.1$ million and increased $\$ 342,000$, or $9.2 \%$, from the second quarter 2012 performance. Factors contributing to this higher level of non-interest income for the quarter included:
a $\$ 194,000$ or $10.7 \%$ increase in trust and investment advisory fees due to increased assets under management which reflects both successful new business development activities and market appreciation of existing assets.
a $\$ 176,000$ increase in bank owned life insurance due to the receipt of a death claim payment.

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## NON-INTEREST EXPENSE

Non-interest expense for the second quarter of 2013 totaled $\$ 10.4$ million and increased by $\$ 375,000$, or $3.7 \%$, from the prior year s second quarter. Factors contributing to the higher non-interest expense in the quarter included:
a $\$ 200,000$ increase in salaries and employee benefits expense due to higher salaries expense and pension expense in the second quarter of 2013. The higher salaries expense reflects merit increases for non-union employees and contractual increases for union employees. The higher pension expense relates to the Company s defined benefit pension plan and reflects the negative impact that the low interest rate environment is having on the discount rate used to calculate the plan liabilities. This increasing pension cost was a key factor causing the Company to implement a soft freeze of its defined benefit pension plan to provide that non-union employees hired on or after January 1, 2013 are not eligible to participate. Instead, such employees are eligible to participate in a qualified 401(k) retirement plan.
a $\$ 213,000$ increase in professional fees expense due largely to higher legal costs, recruitment fees and increases in several other professional fee categories.

## SIX MONTHS ENDED JUNE 30, 2013 VS. SIX MONTHS ENDED JUNE 30, 2012

## PERFORMANCE OVERVIEW

The following table summarizes some of the Company's key performance indicators (in thousands, except per share and ratios).

|  | Six months <br> ended June | Six months <br> ended <br> June 30, |
| :--- | :--- | :--- | :--- |
|  | 30,2013 |  | | Jun |
| :--- | :--- | :--- | :--- |

The Company reported first six months of 2013 net income of $\$ 2,126,000$ and net income available to common shareholders of $\$ 2,022,000$ or $\$ 0.11$ per diluted common share. While net income available to common shareholders decreased by $18.2 \%$ when compared to the first six months of 2012 , earnings per share declined by a lesser amount of $8.3 \%$ due to a lower dividend paid on the SBLF preferred stock and fewer common shares outstanding due to success of the Company s common stock repurchase program. The lower SBLF rate has saved the Company $\$ 421,000$ in preferred stock dividend payments so far in 2013 which has favorably impacted net income available to common shareholders. Overall, sustained improvements in asset quality continued to result in a negative provision for loan losses in the first six months of 2013 but at a lesser level than in the first six months of 2012. The Company s 2013
first six months net income was also negatively impacted by a higher level of non-interest expense. These two negative items were partially offset by higher net interest income, non-interest income and reduced income tax expense in the first six months of 2013.

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## NET INTEREST INCOME AND MARGIN

The following table compares the Company's net interest income performance for the first six months of 2013 to the first six months of 2012 (in thousands, except percentages):
$\left.\begin{array}{lcllll} & \begin{array}{ll}\text { Six months } \\ \text { ended June }\end{array} & \begin{array}{l}\text { Six months } \\ \text { ended June }\end{array} & & & \\ & 30,2013 & 30,2012\end{array}\right)$

N/M not meaningful
The Company s net interest income in the first six months of 2013 has been relatively stable as it increased by only $\$ 84,000$ or $0.5 \%$ when compared to the first six months of 2012 . The Company s first six month 2013 net interest margin of $3.54 \%$ was 10 basis points lower than the net interest margin of $3.64 \%$ for the first six months of 2012 . The lower net interest margin demonstrates the impact of Federal Reserve low interest rate policies which have pressured interest revenue. The Company has been able to mitigate this net interest margin pressure and keep net interest income relatively constant by reducing its cost of funds and growing its earning assets, particularly loans. Specifically, total loans have averaged $\$ 728$ million in the first six months of 2013, which is $\$ 60$ million or $9.0 \%$ higher than the $\$ 668$ million average in the first six months of 2012.

## COMPONENT CHANGES IN NET INTEREST INCOME

Regarding the separate components of net interest income, the Company's total interest income for the first six months of 2013 decreased by $\$ 680,000$ or $3.4 \%$ when compared to the same 2012 period. This decrease was due to a 30 basis point decline in the earning asset yield to $4.27 \%$. Within the earning asset base, the yield on the total loan portfolio decreased by 43 basis points to $4.72 \%$ while the yield on total investment securities dropped by 30 basis points to $2.52 \%$. During the low interest rate environment experienced over the past year, new investment securities and loans that were booked typically had yields that were below the rate on the maturing instruments that they replaced. Despite a $\$ 60$ million or $9.0 \%$ increase in total average loans, total loan interest revenue still dropped by $\$ 61,000$ between years and reflects the impact of this lower interest rate environment. Investment securities interest revenue also declined by $\$ 611,000$ during this same period due to a $\$ 26$ million decrease in the average investment securities portfolio as the Company has utilized cash flow from securities to help fund the previously mentioned loan growth. Additionally, premium amortization on mortgage backed securities continued to remain at high levels due to fast mortgage prepayment speeds.

The Company's total interest expense for the first six months of 2013 decreased by $\$ 764,000$ or $19.0 \%$ when compared to the same 2012 period. This decrease in interest expense was due to a lower cost of funds as the cost of interest bearing liabilities declined by 24 basis points to $0.92 \%$. Management s decision to further reduce interest rates paid on all deposit categories has not had a negative impact on deposit growth and reflects the loyalty of the bank s core deposit base. Specifically, total deposits have averaged $\$ 839$ million in the first half of 2013 which is $\$ 17$ million or $2.1 \%$ higher than the $\$ 822$ million average in the first half of 2012 . The Company has also utilized term advances from the FHLB to help fund its earning asset growth and manage interest rate risk over the past year. The average
balance of FHLB term advances has increased by $\$ 9$ million while the average cost of these advances has declined by 46 basis points to $0.69 \%$.

The table that follows provides an analysis of net interest income on a tax-equivalent basis for the six month periods ended June 30, 2013 and June 30, 2012. For a detailed discussion of the components and assumptions included in the table, see the paragraph before the quarterly table on page 35 .

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Six months ended June 30
(In thousands, except percentages)

|  | 2013 |  |  | 2012 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Average Balance | Interest <br> Income/ <br> Expense | Yield/ <br> Rate | Average Balance | Interest <br> Income/ <br> Expense | Yield/ <br> Rate |
| Interest earning assets: |  |  |  |  |  |  |
| Loans and loans held for sale, net of unearned income | \$727,846 | \$ 17,231 | 4.72\% | \$667,941 | \$17,292 | 5.15\% |
| Interest bearing deposits | 8,324 | 4 | 0.11 | 10,691 | 6 | 0.17 |
| Short-term investment in money market funds | 5,057 | 6 | 0.23 | 4,473 | 10 | 0.44 |
| Investment securities AFS | 149,598 | 1,863 | 2.49 | 179,081 | 2,489 | 2.78 |
| Investment securities HTM | 16,961 | 238 | 2.81 | 13,174 | 223 | 3.39 |
| Total investment securities | 166,559 | 2,101 | 2.52 | 192,255 | 2,712 | 2.82 |
| Total interest earning assets/interest income | 907,786 | 19,342 | 4.27 | 875,360 | 20,020 | 4.57 |
| Non-interest earning assets: |  |  |  |  |  |  |
| Cash and due from banks | 16,845 |  |  | 16,618 |  |  |
| Premises and equipment | 12,475 |  |  | 10,877 |  |  |
| Other assets | 78,961 |  |  | 81,929 |  |  |
| Allowance for loan losses | (11,768 ) |  |  | $(14,162)$ |  |  |
| TOTAL ASSETS | \$1,004,299 |  |  | \$970,622 |  |  |
| Interest bearing liabilities: |  |  |  |  |  |  |
| Interest bearing deposits: |  |  |  |  |  |  |
| Interest bearing demand | \$68,850 | \$62 | 0.18\% | \$57,894 | \$56 | 0.20\% |
| Savings | 88,058 | 69 | 0.16 | 84,541 | 102 | 0.24 |
| Money markets | 210,626 | 367 | 0.35 | 204,300 | 463 | 0.45 |
| Other time | 311,667 | 2,140 | 1.38 | 330,904 | 2,809 | 1.70 |
| Total interest bearing deposits | 679,201 | 2,638 | 0.78 | 677,639 | 3,430 | 1.02 |
| Short-term borrowings: |  |  |  |  |  |  |
| Other short-term borrowings | 9,966 | 13 | 0.25 | 2,337 | 4 | 0.24 |
| Advances from Federal Home Loan Bank | 15,774 | 55 | 0.69 | 6,316 | 36 | 1.15 |
| Guaranteed junior subordinated deferrable interest debentures | 13,085 | 560 | 8.57 | 13,085 | 560 | 8.57 |
| Total interest bearing liabilities/interest expense | 718,026 | 3,266 | 0.92 | 699,377 | 4,030 | 1.16 |
| Non-interest bearing liabilities: |  |  |  |  |  |  |
| Demand deposits | 159,512 |  |  | 143,922 |  |  |
| Other liabilities | 15,634 |  |  | 15,721 |  |  |
| Shareholders' equity | 111,127 |  |  | 111,602 |  |  |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$ 1,004,299 |  |  | \$970,622 |  |  |
| Interest rate spread |  |  | 3.35 |  |  | 3.41 |
|  |  | 16,076 | 3.54\% |  | 15,990 | $3.64 \%$ |

Net interest income/Net interest margin
Tax-equivalent adjustment (13 ) (11 )
Net Interest Income \$ 16,063 \$15,979

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## PROVISION FOR LOAN LOSSES

For the six month period in 2013, the Company recorded a negative loan loss provision of $\$ 100,000$ compared to a $\$ 1,125,000$ negative provision in the first six months of 2012 . There has been $\$ 1,025,000$ less earnings benefit from negative loan loss provisions in 2013. Overall, sustained improvements in asset quality evidenced by low levels of non-performing assets and classified loans has allowed the Company to continue to benefit from negative or modest
loan loss provisions in 2013 while still maintaining strong coverage ratios. For the first six months of 2013, net charge-offs totaled $\$ 1.3$ million or $0.37 \%$ of total loans which represents an increase from the first six months of 2012
when net charge-offs totaled $\$ 181,000$ or $0.05 \%$ of total loans. The higher net charge-offs in 2013 reflect the
resolution of a $\$ 2$ million problem commercial real estate loan for which the Company had previously established reserves in 2012. The allowance for loan losses was $1.48 \%$ of total loans at June 30, 2013, compared to $1.74 \%$ of total loans at December 31, 2012.

## NON-INTEREST INCOME

Non-interest income for the first six months of 2013 totaled $\$ 7.9$ million and increased $\$ 484,000$, or $6.5 \%$, from the first six months 2012 performance. Factors contributing to this higher level of non-interest income in 2013 included:
a $\$ 185,000$ or $5.0 \%$ increase in trust and investment advisory fees due to increased assets under management which reflects both successful new business development activities and market appreciation of existing assets.
a $\$ 100,000$ increase in gains realized on residential mortgage loan sales into the secondary market due to increased mortgage loan production in the first six months of 2013. The higher residential mortgage loan production reflected both increased refinance and purchase activity in 2013.
a $\$ 162,000$ increase in bank owned life insurance due to the receipt of a death claim payment.
NON-INTEREST EXPENSE

Non-interest expense for the first six months of 2013 totaled $\$ 21.1$ million and increased by $\$ 883,000$, or $4.4 \%$, from the prior year s first six months. Factors contributing to the higher non-interest expense in 2013 included:
a $\$ 545,000$ increase in salaries and employee benefits expense due to higher salaries expense, incentive compensation and pension expense in the first six months of 2013. The higher incentive compensation relates to incentives earned on the increased levels of both residential mortgage and commercial loan production. The higher pension expense relates to the Company s defined benefit pension plan and reflects the negative impact that the low interest rate environment is having on the discount rate used to calculate the plan liabilities.
a $\$ 325,000$ increase in professional fees expense due largely to higher legal costs, recruitment fees and increases in several other professional fee categories.

INCOME TAX EXPENSE
The Company recorded an income tax expense of $\$ 864,000$ or an effective tax rate of $28.9 \%$ for the first six months of 2013 compared to an income tax expense of $\$ 1.3$ million or an effective tax rate of $30.8 \%$ for the first six months of
2012. The lower income tax expense and effective rate in 2013 reflects the Company s reduced pre-tax earnings combined with an increased level of tax free earnings from bank owned life insurance. The Company s deferred tax asset was $\$ 11.6$ million at June 30, 2013 and relates primarily to net operating loss carryforwards and the allowance for loan losses.

## SEGMENT RESULTS

Retail banking s net income contribution was $\$ 787,000$ in the second quarter and $\$ 1.6$ million for the first six months of 2013 which was comparable with the $\$ 786,000$ and $\$ 1.6$ million net income contributions for the same 2012 periods. The relatively consistent performance in 2013 reflects continued growth in non-interest income due to strong residential mortgage banking revenues. This non-interest revenue growth was offset by slightly lower net interest income, modestly higher non-interest expense and less benefit from a negative loan loss provision in 2013.

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The commercial banking segment reported net income contributions of $\$ 1.0$ million in the second quarter and $\$ 2.1$ million for the first six months of 2013 compared to $\$ 1.3$ million and $\$ 2.5$ million for the same 2012 periods. Sustained improvements in asset quality continued to result in a credit provision for loan losses in 2013 but at a lesser
level than 2012. Overall, there has been $\$ 893,000$ less earnings benefit from negative loan loss provisions in this segment in 2013. This segment did benefit from higher net interest income due to increased loan balances in 2013. But this was partially offset by greater non-interest expense due largely to the costs associated with all three new loan production offices being operational for the entire six months in 2013.

The trust segment s net income contributions amounted to $\$ 330,000$ for the second quarter and $\$ 506,000$ for the first six months of 2013 compared to $\$ 246,000$ and $\$ 498,000$ for the same 2012 periods. The higher net income contribution in 2013 is due to greater revenue from increased assets under management which reflects both successful new business development activities and market appreciation of existing assets. This more than offset higher non-interest expense from increased personnel costs and legal fees.

The investment/parent segment reported net losses of $\$ 1.1$ million in the second quarter and $\$ 2.0$ million for the first six months of 2013 compared to net losses of $\$ 901,000$ and $\$ 1.7$ million for the same 2012 periods. A reduced level of investment securities and declining yields in the investment securities portfolio due to the continued low interest rate environment have had a negative impact on this segment.

## BALANCE SHEET

The Company's total consolidated assets were $\$ 1.025$ billion at June 30, 2013, which was up by $\$ 24$ million or $2.4 \%$ from December 31, 2012. This asset growth was due entirely to a $\$ 24$ million or $3.3 \%$ increase in total loans during the first half of 2013. This loan growth reflects the successful results of the Company s more intensive sales calling efforts with an emphasis on generating commercial loans and owner occupied commercial real estate loans which qualify as SBLF loans, particularly through its loan production offices.

The Company funded the previously mentioned asset growth with a combination of both increased deposits (\$5 million) and FHLB short-term borrowings and advances ( $\$ 22$ million). The FHLB term advances with maturities between 3 and 5 years now total $\$ 16$ million as the Company $s$ has utilized these advances to help manage interest rate risk in a rising rate environment. The Company $s$ total shareholders equity decreased by $\$ 1.2$ million over the first six
months of 2013 due to the Company s common stock repurchase program and an increase in accumulated other comprehensive loss. The recent increase in intermediate to long term interest rates has caused the value in the AFS investment securities portfolio to decline by a net $\$ 2.4$ million during the first half of 2013 which is reflected in accumulated other comprehensive loss. The Company continues to be considered well capitalized for regulatory purposes with a risk based capital ratio of $15.48 \%$, and an asset leverage ratio of $11.52 \%$ at June 30, 2013. The Company s book value per common share was $\$ 4.70$, its tangible book value per common share was $\$ 4.03$, and its tangible common equity to tangible assets ratio was $7.47 \%$ at June 30, 2013.

On July 2, 2013, the Board of Governors of the Federal Reserve System approved final rules that substantially amend the regulatory risk-based capital rules applicable to the Company and the Bank. The final rules implement the Basel

III regulatory capital reforms, as well as certain changes required by the Dodd-Frank Act, which will require
institutions to, among other things, have more capital and a higher quality of capital by increasing the minimum regulatory capital ratios, and requiring capital buffers. The new rules become effective for the Company on January 1, 2015, with an implementation period that stretches to 2019. The Company is continuing to review the impact of the rules and currently expects that its capital position will be more than adequate to meet the revised regulatory capital requirements.

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## LOAN QUALITY

The following table sets forth information concerning the Company s loan delinquency, non-performing assets, and classified assets (in thousands, except percentages):

|  | $\begin{aligned} & \text { June } 30, \\ & 2013 \end{aligned}$ | December <br> 31, 2012 | $\begin{aligned} & \text { June } 30, \\ & 2012 \end{aligned}$ |
| :---: | :---: | :---: | :---: |
| Total accruing loan delinquency (past due 30 to 89 days) | \$2,049 | \$3,456 | \$3,057 |
| Total non-accrual loans | 3,210 | 5,814 | 4,139 |
| Total non-performing assets including TDR* | 5,028 | 7,224 | 5,077 |
| Accruing loan delinquency, as a percentage of total loans, net of unearned income | 0.28 \% | 0.48 \% | 0.45 |
| Non-accrual loans, as a percentage of total loans, net of unearned income | 0.43 | 0.81 | 0.60 |
| Non-performing assets, as a percentage of total loans, net of unearned income, and other real estate owned | 0.67 | 1.00 | 0.74 |
| Non-performing assets as a percentage of total assets | 0.49 | 0.72 | 0.51 |
| As a percent of average loans, net of unearned income: |  |  |  |
| Annualized net charge-offs | 0.37 | 0.19 | 0.05 |
| Annualized provision (credit) for loan losses | (0.03 ) | (0.11 ) | (0.34 |
| Total classified loans (loans rated substandard or doubtful) | \$15,127 | \$22,717 | \$21,262 |

Non-performing assets are comprised of (i) loans that are on a non-accrual basis, (ii) loans that are contractually past * due 90 days or more as to interest and principal payments, (iii) performing loans classified as a troubled debt restructuring and (iv) other real estate owned.

As a result of successful ongoing problem credit resolution efforts, the Company achieved further asset quality improvements in the first half of 2013. These improvements are evidenced by reduced levels of non-accrual loans, non-performing assets, classified assets and low loan delinquency levels that continue to be well below $1 \%$ of total loans. We continue to closely monitor the loan portfolio given the slow recovery in the economy and the number of relatively large-sized commercial and commercial real estate loans within the portfolio. As of June 30, 2013, the 25 largest credits represented $30.1 \%$ of total loans outstanding.

## ALLOWANCE FOR LOAN LOSSES

The following table sets forth the allowance for loan losses and certain ratios for the periods ended (in thousands, except percentages):

|  | $\begin{aligned} & \text { June 30, } \\ & 2013 \end{aligned}$ | December <br> 31, <br> 2012 | $\begin{aligned} & \text { June } 30, \\ & 2012 \end{aligned}$ |
| :---: | :---: | :---: | :---: |
| Allowance for loan losses | \$11,145 | \$ 12,571 | \$13,317 |
| Allowance for loan losses as a percentage of each of the following: |  |  |  |
| total loans, net of unearned income | 1.50 \% | 1.74 \% | 1.94 |
| total accruing delinquent loans (past due 30 to 89 days) | 543.92 | 363.74 | 435.62 |


| total non-accrual loans | 347.20 | 216.22 | 321.74 |
| :--- | :--- | :--- | :--- |

$\begin{array}{llll}\text { total non-performing assets } & 221.70 & 174.02 & 262.30\end{array}$
The Company has reversed a portion of the allowance for loan losses into earnings in both 2013 and 2012 due to the previously discussed sustained improvement in asset quality. As a result of this reversal and higher net charge-off levels in the first six months of 2013, the balance in the allowance for loan losses has declined but the Company has been able to still maintain strong coverage of non-accrual loans and non-performing assets as indicated in the above table.

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## LIQUIDITY

The Company s liquidity position has been strong during the last several years. Our core retail deposit base has grown over the past three years and has been more than adequate to fund the Company s operations. Cash flow from maturities, prepayments and amortization of securities was also used to either fund loan growth, paydown borrowings, or reinvested back into the securities portfolio. We strive to operate our loan to deposit ratio in a range of $85 \%$ to $95 \%$.
At June 30, 2013, the Company s loan to deposit ratio was $89.4 \%$. We are optimistic that we can increase the loan to deposit ratio in the future given improved commercial loan pipelines, the further development of three new loan production offices, and our focus on small business lending.

Liquidity can be analyzed by utilizing the Consolidated Statement of Cash Flows. Cash and cash equivalents decreased by $\$ 1.2$ million from December 31, 2012, to June 30, 2013, due to $\$ 34.6$ million of cash used in investing activities. This was partially offset by $\$ 24.6$ million of cash provided by financing activities and $\$ 8.8$ million of cash provided by operating activities. Within investing activities, cash provided from investment security maturities and sales was lower than cash used for new investment security purchases by $\$ 7.8$ million. Cash advanced for new loan fundings and purchases (excluding residential mortgages sold in the secondary market) totaled $\$ 104.5$ million and was $\$ 25.5$ million higher than the $\$ 79.0$ million of cash received from loan principal payments and participations. Within financing activities, deposit growth provided $\$ 4.5$ million of cash. Total FHLB borrowings increased as advances, both short-term and long-term, exceeded paydowns by $\$ 21.6$ million and was utilized to fund the earning asset growth. At June 30, 2013, the Company had immediately available $\$ 302$ million of overnight borrowing capacity at the FHLB and $\$ 39$ million of unsecured federal funds lines with correspondent banks.

The holding company had $\$ 17.2$ million of cash, short-term investments, and securities at June 30, 2013, which represented an increase of approximately $\$ 453,000$ since year-end 2012. Additionally, dividend payments from our subsidiaries can also provide ongoing cash to the holding company. At June 30, 2013, our subsidiary Bank had \$2.2 million of cash available for immediate dividends to the holding company under the applicable regulatory formulas. As such, the holding company has strong liquidity to meet its trust preferred debt service requirements and preferred stock dividends, which should approximate $\$ 1.2$ million over the next twelve months. Additionally, the Company has ample cash to provide for its $\$ 0.01$ per share quarterly common stock cash dividend which will require $\$ 188,000$ of cash on a quarterly basis.

## CAPITAL RESOURCES

The Company meaningfully exceeds all regulatory capital ratios for each of the periods presented and is considered well capitalized. The asset leverage ratio was $11.52 \%$ and the risk based capital ratio was $15.48 \%$ at June 30, 2013. The Company s tangible common equity to tangible assets ratio was $7.47 \%$ at June 30, 2013. These ratios reflect the completion of $\$ 1.2$ million common stock buyback program where we repurchased $2 \%$ of our outstanding common shares during the second quarter of 2013. We anticipate that we will maintain our strong capital ratios throughout the remainder of 2013. Capital generated from earnings will be utilized to pay the SBLF preferred dividend, common stock cash dividend and will also support anticipated balance sheet growth.

## INTEREST RATE SENSITIVITY

The following table presents an analysis of the sensitivity inherent in the Company s net interest income and market value of portfolio equity. The interest rate scenarios in the table compare the Company s base forecast, which was prepared using a flat interest rate scenario, to scenarios that reflect immediate interest rate changes of 100 and 200
basis points. Note that we suspended the 200 basis point downward rate shock since it has little value due to the absolute low level of interest rates. Each rate scenario contains unique prepayment and repricing assumptions that are applied to the Company s existing balance sheet that was developed under the flat interest rate scenario.

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Interest Rate Scenario

200bp increase
100bp increase
100bp decrease

| Variability <br> of Net | Change in <br> Market Value |  |
| :---: | :--- | :--- |
| Interest | of Portfolio |  |
| Income | Equity |  |
| 0.9 | $\%$ | 14.7 |
| 1.1 | $\%$ |  |
| $(4.7$ | $)$ | 8.9 |

The variability of net interest income is negative in the 100 basis point downward rate scenario as the Company has more exposure to assets repricing downward to a greater extent than liabilities due to the absolute low level of interest rates with the fed funds rate currently at $0.25 \%$. The variability of net interest income is positive in the upward rate shocks due to the Company s short duration investment securities portfolio and scheduled repricing of loans tied to LIBOR or prime. Also, the Company expects that it will not have to reprice its core deposit accounts up as quickly when interest rates rise. The market value of portfolio equity increases in the upward rate shocks due to the improved
value of the Company s core deposit base. Negative variability of market value of portfolio equity occurs in the downward rate shock due to a reduced value for core deposits.

## OFF BALANCE SHEET ARRANGEMENTS

The Company incurs off-balance sheet risks in the normal course of business in order to meet the financing needs of its customers. These risks derive from commitments to extend credit and standby letters of credit. Such commitments and standby letters of credit involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated financial statements. The Company had various outstanding commitments to extend credit
approximating $\$ 141.5$ million and standby letters of credit of $\$ 13.3$ million as of June 30 , 2013. The Company s exposure to credit loss in the event of nonperformance by the other party to these commitments to extend credit and standby letters of credit is represented by their contractual amounts. The Company uses the same credit and collateral policies in making commitments and conditional obligations as for all other lending.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The accounting and reporting policies of the Company are in accordance with Generally Accepted Accounting Principles and conform to general practices within the banking industry. Accounting and reporting policies for the allowance for loan losses, goodwill, income taxes, and investment securities are deemed critical because they involve the use of estimates and require significant management judgments. Application of assumptions different than those used by the Company could result in material changes in the Company s financial position or results of operation.

# ACCOUNT Allowance for Loan Losses BALANCE SHEET REFERENCE Allowance for loan losses INCOME STATEMENT REFERENCE Provision (credit) for loan losses DESCRIPTION 

The allowance for loan losses is calculated with the objective of maintaining reserve levels believed by management to be sufficient to absorb estimated probable credit losses. Management s determination of the adequacy of the
allowance is based on periodic evaluations of the credit portfolio and other relevant factors. However, this quarterly evaluation is inherently subjective as it requires material estimates, including, among others, likelihood of customer default, loss given default, exposure at default, the amounts and timing of expected future cash flows on impaired loans, value of collateral, estimated losses on consumer loans and residential mortgages, and general amounts for historical loss experience. This process also considers economic conditions, uncertainties in estimating losses and inherent risks in the various credit portfolios. All of these factors may be susceptible to significant change. Also, the allocation of the allowance for credit losses to specific loan pools is based on historical loss trends and management s judgment concerning those trends.

Commercial and commercial real estate loans are the largest category of credits and the most sensitive to changes in assumptions and judgments underlying the determination of the allowance for loan loss. Approximately $\$ 8.8$ million, or $79 \%$, of the total allowance for loan losses at June 30, 2013 has been allocated to these two loan categories. This allocation also considers other relevant factors such as actual

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versus estimated losses, economic trends, delinquencies, levels of non-performing and TDR loans, concentrations of credit, trends in loan volume, experience and depth of management, examination and audit results, effects of any changes in lending policies and trends in policy, financial information and documentation exceptions. To the extent actual outcomes differ from management estimates, additional provision for credit losses may be required that would adversely impact earnings in future periods.

# ACCOUNT Goodwill BALANCE SHEET REFERENCE Goodwill INCOME STATEMENT REFERENCE Goodwill impairment DESCRIPTION 

The Company considers our accounting policies related to goodwill to be critical because the assumptions or judgment used in determining the fair value of assets and liabilities acquired in past acquisitions are subjective and complex. As a result, changes in these assumptions or judgment could have a significant impact on our financial condition or results of operations.

The fair value of acquired assets and liabilities, including the resulting goodwill, was based either on quoted market prices or provided by other third party sources, when available. When third party information was not available, estimates were made in good faith by management primarily through the use of internal cash flow modeling techniques. The assumptions that were used in the cash flow modeling were subjective and are susceptible to significant changes. The Company routinely utilizes the services of an independent third party that is regarded within the banking industry as an expert in valuing core deposits to monitor the ongoing value and changes in the Company s core deposit base. These core deposit valuation updates are based upon specific data provided from statistical analysis of the Company s own deposit behavior to estimate the duration of these non-maturity deposits combined with market interest rates and other economic factors.

Goodwill arising from business combinations represents the value attributable to unidentifiable intangible elements in the business acquired. The Company s goodwill relates to value inherent in the banking and wealth management businesses, and the value is dependent upon the Company s ability to provide quality, cost-effective services in the
face of free competition from other market participants on a regional basis. This ability relies upon continuing investments in processing systems, the development of value-added service features and the ease of use of the Company s services. As such, goodwill value is supported ultimately by revenue that is driven by the volume of business transacted and the loyalty of the Company s deposit and customer base over a longer time frame. The quality and value of a Company $s$ assets is also an important factor to consider when performing goodwill impairment testing. A decline in earnings as a result of a lack of growth or the inability to deliver cost-effective value added services over sustained periods can lead to impairment of goodwill.

Goodwill which has an indefinite useful life is tested for impairment at least annually and written down and charged to results of operations only in periods in which the recorded value is more than the estimated fair value. As of June 30, 2013, goodwill was not considered impaired; however, deteriorating economic conditions could result in impairment, which could adversely affect earnings in future periods.

## ACCOUNT Income Taxes BALANCE SHEET REFERENCE Net deferred tax asset

## INCOME STATEMENT REFERENCE Provision for income tax expense DESCRIPTION

The provision for income taxes is the sum of income taxes both currently payable and deferred. The changes in deferred tax assets and liabilities are determined based upon the changes in differences between the basis of assets and liabilities for financial reporting purposes and the basis of assets and liabilities as measured by the enacted tax rates that management estimates will be in effect when the differences reverse. This income tax review is completed on a quarterly basis.

In relation to recording the provision for income taxes, management must estimate the future tax rates applicable to the reversal of tax differences, make certain assumptions regarding whether tax differences are permanent or temporary and the related timing of the expected reversal. Also, estimates are made as to whether taxable operating income in future periods will be sufficient to fully recognize any gross deferred tax assets. If recovery is not likely, we must increase our provision for taxes by recording a valuation allowance

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against the deferred tax assets that we estimate will not ultimately be recoverable. Alternatively, we may make estimates about the potential usage of deferred tax assets that decrease our valuation allowances. As of June 30, 2013, we believe that all of the deferred tax assets recorded on our balance sheet will ultimately be recovered and that no valuation allowances were needed.

In addition, the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations. We recognize liabilities for anticipated tax audit issues based on our estimate of whether, and the extent to which, additional taxes will be due. If we ultimately determine that payment of these amounts is unnecessary, we reverse the liability and recognize a tax benefit during the period in which we determine that the liability is no longer necessary. We record an additional charge in our provision for taxes in the period in which we determine that the recorded tax liability is less than we expect the ultimate assessment to be.

# ACCOUNT Investment Securities BALANCE SHEET REFERENCE Investment securities INCOME STATEMENT REFERENCE Net realized gains (losses) on investment securities DESCRIPTION 

Available-for-sale and held-to-maturity securities are reviewed quarterly for possible other-than-temporary impairment. The review includes an analysis of the facts and circumstances of each individual investment such as the severity of loss, the length of time the fair value has been below cost, the expectation for that security s performance, the creditworthiness of the issuer and the Company s intent and ability to hold the security to recovery. A decline in
value that is considered to be other-than-temporary is recorded as a loss within non-interest income in the Consolidated Statements of Operations. At June 30, 2013, the unrealized losses in the available-for-sale security portfolio were comprised of securities issued by government agencies or government sponsored agencies and certain high quality corporate securities. The Company believes the unrealized losses are primarily a result of increases in market yields from the time of purchase. In general, as market yields rise, the value of securities will decrease; as market yields fall, the fair value of securities will increase. Management generally views changes in fair value caused by changes in interest rates as temporary; therefore, these securities have not been classified as other-than-temporarily
impaired. Management has also concluded that based on current information we expect to continue to receive scheduled interest payments as well as the entire principal balance. Furthermore, management does not intend to sell
these securities and does not believe it will be required to sell these securities before they recover in value.

## FORWARD LOOKING STATEMENT

## THE STRATEGIC FOCUS:

The challenge for the future is to improve earnings performance to peer levels through a disciplined focus on community banking and improving the profitability of our Trust Company. In accordance with our strategic plan, AmeriServ will maintain its focus as a community bank delivering banking and trust services to the best of our ability and focus on further growing revenues by leveraging our strong capital base and infrastructure. This Company will not succumb to the lure of quick fixes and fancy financial gimmicks. It is our plan to continue to build AmeriServ into a potent banking force in this region and in this industry. Our focus encompasses the following:

Customer Service it is the existing and prospective customer that AmeriServ must satisfy. This means good products and fair prices. But it also means quick response time and professional competence. It means speedy problem resolution and a minimizing of bureaucratic frustrations. AmeriServ is training and motivating its staff to meet these standards while providing customers with more banking options that involve leading technologies such as computers, smartphones, and tablets to conduct business.
Revenue Growth It is necessary for AmeriServ to focus on growing revenues. This means loan growth, deposit growth and fee growth. It also means close coordination between all customer service areas so as many revenue producing products as possible can be presented to existing and prospective customers. The Company s Strategic Plan contains action plans in each of these areas particularly on increasing loans through the opening of several loan production offices. There will be a particular focus on small business commercial lending so that we can maintain the interest rate

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paid on our SBLF preferred stock at its lowest possible level. An examination of the peer bank database provides ample proof that a well-executed community banking business model can generate a reliable and rewarding revenue stream.
Expense Rationalization AmeriServ Financial remains focused on trying to rationalize expenses. This has not been a program of broad based cuts, but has been targeted so AmeriServ stays strong but spends less. However, this initiative takes on new importance because it is critical to be certain that future expenditures are directed to areas that are playing a positive role in the drive to improve revenues.
This Form 10-Q contains various forward-looking statements and includes assumptions concerning the Company s beliefs, plans, objectives, goals, expectations, anticipations, estimates, intentions, operations, future results, and prospects, including statements that include the words may, could, should, would, believe, expect, anticipat intend, plan or similar expressions. These forward-looking statements are based upon current expectations, are subject
to risk and uncertainties and are applicable only as of the dates of such statements. Forward-looking statements involve risks, uncertainties and assumptions. Although we do not make forward-looking statements unless we believe we have a reasonable basis for doing so, we cannot guarantee their accuracy. You should not put undue reliance on any forward-looking statements. These statements speak only as of the date of this Form 10-Q, even if subsequently made available on our website or otherwise, and we undertake no obligation to update or revise these statements to reflect events or circumstances occurring after the date of this Form 10-Q. In connection with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, the Company provides the following cautionary statement identifying important factors (some of which are beyond the Company s control) which could cause the actual results or events to differ materially from those set forth in or implied by the forward-looking statements and related assumptions.

Such factors include the following: (i) the effect of changing regional and national economic conditions; (ii) the effects of trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System; (iii) significant changes in interest rates and prepayment speeds; (iv) inflation, stock and bond market, and monetary fluctuations; (v) credit risks of commercial, real estate, consumer, and other lending activities; (vi) changes in federal and state banking and financial services laws and regulations; (vii) the presence in the Company s market area of competitors with greater financial resources than the Company; (viii) the timely development of competitive new products and services by the Company and the acceptance of those products and services by customers and regulators (when required); (ix) the willingness of customers to substitute competitors products and services for those of the Company and vice versa; ( x ) changes in consumer spending and savings habits; (xi) unanticipated regulatory or judicial proceedings; and (xii) other external developments which could materially impact the Company s operational and financial performance.

The foregoing list of important factors is not exclusive, and neither such list nor any forward-looking statement takes into account the impact that any future acquisition may have on the Company and on any such forward-looking statement.

## Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The Company manages market risk, which for the Company is primarily interest rate risk, through its asset liability management process and committee, see further discussion in Interest Rate Sensitivity section of the M.D. \& A.

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## Item 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures. The Company s management carried out an evaluation, under the supervision and with the participation of the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and the operation of the Company s disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of June 30, 2013, pursuant to Exchange Act

Rule 13a-15. Based upon that evaluation, the Chief Executive Officer along with the Chief Financial Officer concluded that the Company s disclosure controls and procedures as of June 30, 2013, are effective.
(b) Changes in Internal Controls. There have been no changes in AmeriServ Financial Inc. s internal controls over financial reporting that occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

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## Part II Other Information

## Item 1. Legal Proceedings

There are no material proceedings to which the Company or any of our subsidiaries are a party or by which, to the Company s knowledge, we, or any of our subsidiaries, are threatened. All legal proceedings presently pending or threatened against the Company or our subsidiaries involve routine litigation incidental to our business or that of the subsidiary involved and are not material in respect to the amount in controversy.

Item 1A. Risk Factors

Not Applicable

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Following are the Company s monthly common stock purchases during the second quarter of 2013. All shares are repurchased under Board of Directors authorization. The Company completed the most recent $2 \%$ common stock repurchase program in the second quarter of 2013.

| Period |  | Total number of shares purchased |  | erage price <br> d per share | Total number of shares purchased as part of publicly announced plan | Maximum number of shares that may yet be purchased under the plan |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| April 1 | 30, 2013 |  |  |  |  | 384,000 |
| May 1 | 31,2013 | 331,800 |  | 3.04 | 331,800 | 52,200 |
| June 1 | 30, 2013 | 52,200 |  | 3.12 | 384,000 |  |
| Total |  | 384,000 |  | 3.05 |  |  |

None

# Item 4. Mine Safety Disclosures 

None
Item 5. Other Information

None

## Item 6. Exhibits

Amended and Restated Articles of Incorporation as amended through August 11, 2011, exhibit 3.13 .1 to the Registration Statement on Form S-8 (File No. 333-176869) filed on September 16, 2011.
3.2 Bylaws, as amended and restated on May 16, 2013, Exhibit 3.2 to the Form 8-K filed May 22, 2013.
15.1 Report of S.R. Snodgrass, A.C. regarding unaudited interim financial statement information. 15.2 Awareness Letter of S.R. Snodgrass, A.C.
31.1 Certification pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
31.2 Certification pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
32.1 Certification pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.
32.2 Certification pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.
The following information from AMERISERV FINANCIAL, INC. s Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, formatted in XBRL (eTensible Business
101 Reporting Language): (i) Consolidated Balance Sheets (unaudited), (ii) Consolidated Statements of Operations (unaudited), (iii) Consolidated Statements of Cash Flows (unaudited), and (iv) Notes to the Consolidated Financial Statements (unaudited).

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

## AmeriServ Financial, Inc.

Registrant

/s/Glenn L. Wilson

Date: August 9, 2013
Glenn L. Wilson
President and Chief Executive Officer
/s/Jeffrey A. Stopko
Date: August 9, 2013

Jeffrey A. Stopko

Executive Vice President and Chief Financial Officer


[^0]:    US Agency securities
    US Agency mortgage-backed securities
    Corporate bonds
    Fair value of swap asset
    Fair value of swap liability

