

BRYN MAWR BANK CORP  
Form 10-Q  
August 08, 2014  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**Form 10-Q**

**Quarterly Report Under Section 13 or 15 (d)**  
**of the Securities and Exchange Act of 1934.**

**For Quarter ended June 30, 2014**

**Commission File Number 1-35746**

**Bryn Mawr Bank Corporation**

**(Exact name of registrant as specified in its charter)**

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

**23-2434506**  
**(I.R.S. Employer**  
**identification No.)**

**801 Lancaster Avenue, Bryn Mawr, Pennsylvania**  
**(Address of principal executive offices)**

**19010**  
**(Zip Code)**

**Registrant's telephone number, including area code (610) 525-1700**

**Not Applicable**

**Former name, former address and fiscal year, if changed since last report.**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

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

| <b>Class</b>                | <b>Outstanding at August 5, 2014</b> |
|-----------------------------|--------------------------------------|
| Common Stock, par value \$1 | 13,728,436                           |

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**BRYN MAWR BANK CORPORATION AND SUBSIDIARIES**

**FORM 10-Q**

**QUARTER ENDED June 30, 2014**

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**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements****BRYN MAWR BANK CORPORATION AND SUBSIDIARIES****Consolidated Balance Sheets Unaudited**

| <i>(dollars in thousands)</i>  | (unaudited)<br><b>June 30,<br/>2014</b> | <b>December 31,<br/>2013</b> |
|--|---|------------------------------|
| <b>Assets</b>  |   |                              |
| Cash and due from banks  | \$ 17,018                               | \$ 13,453                    |
| Interest bearing deposits with banks   | 85,946                                  | 67,618                       |
| Cash and cash equivalents  | 102,964                                 | 81,071                       |
| Investment securities available for sale, at fair value (amortized cost of \$264,039 and \$287,127 as of June 30, 2014 and December 31, 2013 respectively) | 266,402                                 | 285,808                      |
| Investment securities, trading   | 3,597                                   | 3,437                        |
| Loans held for sale  | 1,631                                   | 1,350                        |
| Portfolio loans and leases   | 1,615,542                               | 1,547,185                    |
| Less: Allowance for loan and lease losses  | (15,470)                                | (15,515)                     |
| Net portfolio loans and leases   | 1,600,072                               | 1,531,670                    |
| Premises and equipment, net  | 32,679                                  | 31,796                       |
| Accrued interest receivable  | 5,526                                   | 5,728                        |
| Deferred income taxes  | 5,984                                   | 8,690                        |
| Mortgage servicing rights  | 4,760                                   | 4,750                        |
| Bank owned life insurance  | 20,375                                  | 20,220                       |
| Federal Home Loan Bank stock   | 12,775                                  | 11,654                       |
| Goodwill   | 32,843                                  | 32,843                       |
| Intangible assets  | 18,092                                  | 19,365                       |
| Other investments  | 4,507                                   | 4,437                        |
| Other assets   | 19,018                                  | 18,846                       |
| <b>Total assets</b>  | <b>\$ 2,131,225</b>                     | <b>\$ 2,061,665</b>          |
| <b>Liabilities</b>   |   |                              |
| <b>Deposits:</b>   |   |                              |
| Non-interest-bearing   | \$ 436,739                              | \$ 426,640                   |
| Interest-bearing   | 1,183,193                               | 1,164,707                    |
| <b>Total deposits</b>  | <b>1,619,932</b>                        | <b>1,591,347</b>             |
| Short-term borrowings  | 13,320                                  | 10,891                       |
| FHLB advances and other borrowings   | 233,132                                 | 205,644                      |

|   |                     |                     |
|---|---------------------|---------------------|
| Accrued interest payable  | 835                 | 841                 |
| Other liabilities   | 20,635              | 23,044              |
| <b>Total liabilities</b>  | <b>1,887,854</b>    | <b>1,831,767</b>    |
| <b>Shareholders equity</b>  |                     |                     |
| Common stock, par value \$1; authorized 100,000,000 shares; issued 16,670,884 and 16,596,869 shares as of June 30, 2014 and December 31, 2013, respectively, and outstanding of 13,719,337 and 13,650,354 as of June 30, 2014 and December 31, 2013, respectively | 16,671              | 16,597              |
| Paid-in capital in excess of par value  | 97,967              | 95,673              |
| Less: Common stock in treasury at cost 2,951,547 and 2,946,515 shares as of June 30, 2014 and December 31, 2013, respectively   | (31,017)            | (30,764)            |
| Accumulated other comprehensive loss, net of tax benefit  | (3,548)             | (5,565)             |
| Retained earnings   | 163,298             | 153,957             |
| <b>Total shareholders equity</b>  | <b>243,371</b>      | <b>229,898</b>      |
| <b>Total liabilities and shareholders equity</b>  | <b>\$ 2,131,225</b> | <b>\$ 2,061,665</b> |

The accompanying notes are an integral part of the unaudited consolidated financial statements.

Table of Contents**BRYN MAWR BANK CORPORATION AND SUBSIDIARIES****Consolidated Statements of Income Unaudited**

| <i>(dollars in thousands, except per share data)</i>                 | <b>Three Months Ended June 30,</b> |               | <b>Six Months Ended June 30,</b> |               |
|--|------------------------------------|---------------|----------------------------------|---------------|
|  | <b>2014</b>                        | <b>2013</b>   | <b>2014</b>                      | <b>2013</b>   |
| <b>Interest income:</b>  |                                    |               |                                  |               |
| Interest and fees on loans and leases                                | \$ 19,876                          | \$ 18,219     | \$ 38,918                        | \$ 36,030     |
| Interest on cash and cash equivalents                                | 44                                 | 41            | 81                               | 110           |
| Interest on investment securities:                                   |                                    |               |                                  |               |
| Taxable  | 891                                | 829           | 1,842                            | 1,687         |
| Non-taxable  | 101                                | 98            | 204                              | 182           |
| Dividends  | 29                                 | 30            | 57                               | 63            |
| <b>Total interest income</b>   | <b>20,941</b>                      | <b>19,217</b> | <b>41,102</b>                    | <b>38,072</b> |
| <b>Interest expense on:</b>  |                                    |               |                                  |               |
| Deposits   | 713                                | 694           | 1,402                            | 1,469         |
| Short-term borrowings  | 5                                  | 4             | 8                                | 7             |
| FHLB advances and other borrowings                                   | 781                                | 596           | 1,527                            | 1,264         |
| <b>Total interest expense</b>  | <b>1,499</b>                       | <b>1,294</b>  | <b>2,937</b>                     | <b>2,740</b>  |
| <b>Net interest income</b>   | <b>19,442</b>                      | <b>17,923</b> | <b>38,165</b>                    | <b>35,332</b> |
| <b>Provision for loan and lease losses</b>                           | <b>(100)</b>                       | <b>1,000</b>  | <b>650</b>                       | <b>1,804</b>  |
| <b>Net interest income after provision for loan and lease losses</b> | <b>19,542</b>                      | <b>16,923</b> | <b>37,515</b>                    | <b>33,528</b> |
| <b>Non-interest income:</b>  |                                    |               |                                  |               |
| Fees for wealth management services                                  | 9,499                              | 9,094         | 18,412                           | 17,443        |
| Service charges on deposits  | 656                                | 596           | 1,257                            | 1,180         |
| Loan servicing and other fees  | 428                                | 448           | 874                              | 899           |
| Net gain on sale of residential mortgage loans                       | 537                                | 1,492         | 861                              | 3,010         |
| Net gain on sale of investment securities available for sale         | 85                                 |               | 81                               | 2             |
| Net gain (loss) on sale of other real estate owned ( OREO )          | 220                                | (141)         | 220                              | (193)         |
| Bank owned life insurance ( BOLI ) income                            | 74                                 | 85            | 155                              | 198           |
| Other operating income   | 1,258                              | 1,369         | 2,036                            | 2,194         |
| <b>Total non-interest income</b>                                     | <b>12,757</b>                      | <b>12,943</b> | <b>23,896</b>                    | <b>24,733</b> |
| <b>Non-interest expenses:</b>  |                                    |               |                                  |               |
| Salaries and wages   | 9,694                              | 9,086         | 18,134                           | 17,896        |
| Employee benefits  | 1,809                              | 2,212         | 3,788                            | 4,537         |
| Net gain on curtailment of nonqualified pension plan                 |                                    | (120)         |                                  | (690)         |

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|   |                   |                   |                   |                   |
|---|-------------------|-------------------|-------------------|-------------------|
| Occupancy and bank premises                     | 1,683             | 1,728             | 3,616             | 3,478             |
| Furniture, fixtures, and equipment              | 1,089             | 1,221             | 2,072             | 2,040             |
| Advertising                                     | 455               | 380               | 794               | 792               |
| Amortization of mortgage servicing rights       | 128               | 218               | 242               | 430               |
| Net recovery of mortgage servicing rights       | (3)               | (91)              | (11)              | (20)              |
| Amortization of intangible assets               | 636               | 660               | 1,273             | 1,321             |
| FDIC insurance                                  | 242               | 275               | 514               | 533               |
| Due diligence and merger-related expenses       | 377               | 688               | 641               | 1,402             |
| Early extinguishment of debt costs and premiums |                   |                   |                   | 347               |
| Professional fees                               | 914               | 664               | 1,507             | 1,239             |
| Pennsylvania bank shares tax                    | 412               | 366               | 780               | 530               |
| Other operating expenses                        | 3,190             | 3,237             | 6,175             | 6,924             |
| <b>Total non-interest expenses</b>              | <b>20,626</b>     | <b>20,524</b>     | <b>39,525</b>     | <b>40,759</b>     |
| Income before income taxes                      | 11,673            | 9,342             | 21,886            | 17,502            |
| Income tax expense                              | 4,069             | 3,090             | 7,593             | 5,930             |
| <b>Net income</b>                               | <b>\$ 7,604</b>   | <b>\$ 6,252</b>   | <b>\$ 14,293</b>  | <b>\$ 11,572</b>  |
| <b>Basic earnings per common share</b>          | <b>\$ 0.56</b>    | <b>\$ 0.47</b>    | <b>\$ 1.06</b>    | <b>\$ 0.87</b>    |
| <b>Diluted earnings per common share</b>        | <b>\$ 0.55</b>    | <b>\$ 0.46</b>    | <b>\$ 1.03</b>    | <b>\$ 0.86</b>    |
| <b>Dividends declared per share</b>             | <b>\$ 0.18</b>    | <b>\$ 0.17</b>    | <b>\$ 0.36</b>    | <b>\$ 0.34</b>    |
| Weighted-average basic shares outstanding       | 13,531,155        | 13,280,624        | 13,508,311        | 13,243,289        |
| Dilutive shares                                 | 304,998           | 227,150           | 304,913           | 228,782           |
| <b>Adjusted weighted-average diluted shares</b> | <b>13,836,153</b> | <b>13,507,774</b> | <b>13,813,224</b> | <b>13,472,071</b> |

The accompanying notes are an integral part of the unaudited consolidated financial statements.

Table of Contents**BRYN MAWR BANK CORPORATION AND SUBSIDIARIES****Consolidated Statements of Comprehensive Income Unaudited**

| <i>(dollars in thousands)</i>  | <b>Three Months Ended June 30,</b> |                 | <b>Six Months Ended June 30,</b> |                  |
|--|------------------------------------|-----------------|----------------------------------|------------------|
|  | <b>2014</b>                        | <b>2013</b>     | <b>2014</b>                      | <b>2013</b>      |
| Net income   | \$ 7,604                           | \$ 6,252        | \$ 14,293                        | \$ 11,572        |
| Other comprehensive income (loss):   |                                    |                 |                                  |                  |
| <b>Net change in unrealized gains (losses) on investment securities available for sale:</b>  |                                    |                 |                                  |                  |
| Net unrealized gains (losses) arising during the period, net of tax expense (benefit) of \$702, \$(1,761), \$1,317 and \$(1,769), respectively                                 | 1,303                              | (3,270)         | 2,445                            | (3,286)          |
| Less: reclassification adjustment for net (gains) losses on sales realized in net income, net of tax expense (benefit) of \$30, \$0, \$28 and \$1, respectively                | (55)                               |                 | (52)                             | (1)              |
| Unrealized investment gains (losses), net of tax expense (benefit) of \$672, \$(1,761), \$1,289 and \$(1,768), respectively  | 1,248                              | (3,270)         | 2,393                            | (3,287)          |
| <b>Net change in fair value of derivative used for cash flow hedge:</b>  |                                    |                 |                                  |                  |
| Change in fair value of hedging instruments, net of tax (benefit) expense of \$(130), \$260, \$(253) and \$324, respectively   | (242)                              | 482             | (469)                            | 601              |
| <b>Net change in unfunded pension liability:</b>   |                                    |                 |                                  |                  |
| Change in unfunded pension liability related to unrealized loss, prior service cost and transition obligation, net of tax expense of \$24, \$133, \$50 and \$267, respectively | 47                                 | 248             | 93                               | 494              |
| Change in unfunded pension liability related to curtailment, net of tax expense of \$0, \$0, \$0 and \$627, respectively   |                                    |                 |                                  | 1,165            |
| Total change in unfunded pension liability, net of tax expense of \$25, \$133, \$50 and \$894, respectively  | 47                                 | 248             | 93                               | 1,659            |
| Total other comprehensive income (loss)  | 1,053                              | (2,540)         | 2,017                            | (1,027)          |
| <b>Total comprehensive income</b>  | <b>\$ 8,657</b>                    | <b>\$ 3,712</b> | <b>\$ 16,310</b>                 | <b>\$ 10,545</b> |

The accompanying notes are an integral part of the unaudited consolidated financial statements.



**Table of Contents****BRYN MAWR BANK CORPORATION AND SUBSIDIARIES****Consolidated Statements of Cash Flows Unaudited**

| <i>(dollars in thousands)</i>   | <b>Six Months Ended June 30,</b> |             |
|---|----------------------------------|-------------|
|   | <b>2014</b>                      | <b>2013</b> |
| <b>Operating activities:</b>  |                                  |             |
| Net Income  | \$ 14,293                        | \$ 11,572   |
| Adjustments to reconcile net income to net cash provided by operating activities:           |                                  |             |
| Provision for loan and lease losses   | 650                              | 1,804       |
| Depreciation of fixed assets  | 1,606                            | 1,400       |
| Net amortization of investment premiums and discounts                                       | 1,212                            | 2,282       |
| Net gain on sale of investment securities available for sale                                | (81)                             | (2)         |
| Net gain on sale of residential mortgage loans  | (861)                            | (3,010)     |
| Stock based compensation cost   | 609                              | 469         |
| Amortization and net impairment of mortgage servicing rights                                | 231                              | 410         |
| Net accretion of fair value adjustments   | (1,719)                          | (1,628)     |
| Amortization of intangible assets   | 1,273                            | 1,321       |
| Net (gain) loss on sale of OREO   | (220)                            | 193         |
| Net increase in cash surrender value of bank owned life insurance ( BOLI )                  | (155)                            | (198)       |
| Other, net  | (3,099)                          | 377         |
| Loans originated for resale   | (24,672)                         | (97,492)    |
| Proceeds from loans sold  | 25,011                           | 100,998     |
| Provision for deferred income taxes   | 1,620                            | 1,123       |
| Change in income taxes payable/receivable   | (187)                            | 293         |
| Change in accrued interest receivable   | 202                              | (142)       |
| Change in accrued interest payable  | (6)                              | (318)       |
| Net cash provided by operating activities   | 15,707                           | 19,452      |
| <b>Investing activities:</b>  |                                  |             |
| Purchases of investment securities available for sale                                       | (21,827)                         | (70,362)    |
| Proceeds from maturity of investment securities and paydowns of mortgage-related securities | 18,159                           | 33,417      |
| Proceeds from sale of investment securities available for sale                              | 4,125                            | 496         |
| Net change in FHLB stock  | (1,121)                          | (2,267)     |
| Proceeds from calls of investment securities  | 21,500                           | 22,512      |
| Net change in other investments   | (70)                             | (32)        |
| Net portfolio loan and lease originations   | (68,225)                         | (33,417)    |
| Purchases of premises and equipment   | (2,545)                          | (1,233)     |
| Capitalize OREO costs   |                                  | (485)       |
| Proceeds from sale of OREO  | 1,097                            | 488         |
| Net cash used in investing activities   | (48,907)                         | (50,883)    |
| <b>Financing activities:</b>  |                                  |             |

|   |            |            |
|---|------------|------------|
| Change in deposits  | 28,598     | (84,738)   |
| Change in short-term borrowings                                       | 2,429      | 62,365     |
| Dividends paid  | (4,888)    | (4,498)    |
| Change in FHLB advances and other borrowings                          | 27,548     | (8,583)    |
| Payment of contingent consideration for business combinations         |            | (1,050)    |
| Excess tax benefit from stock-based compensation                      | 240        | 148        |
| Proceeds from sale of treasury stock from deferred compensation plans |            | 365        |
| Net purchase of treasury stock  | (243)      |            |
| Proceeds from issuance of common stock                                | 32         | 107        |
| Proceeds from exercise of stock options                               | 1,377      | 1,740      |
| Net cash provided by (used in) financing activities                   | 55,093     | (34,144)   |
| Change in cash and cash equivalents                                   | 21,893     | (65,575)   |
| Cash and cash equivalents at beginning of period                      | 81,071     | 175,686    |
| Cash and cash equivalents at end of period                            | \$ 102,964 | \$ 110,111 |

**Supplemental cash flow information:**

## Cash paid during the year for:

|              |          |          |
|--------------|----------|----------|
| Income taxes | \$ 5,921 | \$ 4,366 |
| Interest     | 2,943    | 3,058    |

**Non-cash information:**

|  |          |            |
|--|----------|------------|
| Change in other comprehensive loss                           | \$ 2,017 | \$ (1,027) |
| Change in deferred tax due to change in comprehensive income | 1,086    | (552)      |
| Transfer of loans to other real estate owned                 | 875      | 495        |

The accompanying notes are an integral part of the unaudited consolidated financial statements.

**Table of Contents****BRYN MAWR BANK CORPORATION AND SUBSIDIARIES****Consolidated Statements of Changes In Shareholders Equity Unaudited**

| <i>(dollars in thousands,<br/>except per share<br/>information)</i>             | <b>For the Six Months Ended June 30, 2014</b>    |                     |                        |                                   |                       |   |                              |  |
|---|--|---------------------|------------------------|-----------------------------------|-----------------------|---|------------------------------|--|
|   | <b>Shares of<br/>Common<br/>Stock<br/>Issued</b> | <b>Common Stock</b> | <b>Preferred Stock</b> | <b>Additional Paid-in Capital</b> | <b>Treasury Stock</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Loss</b> | <b>Retained<br/>Earnings</b> | <b>Total<br/>Shareholders<br/>Equity</b> |
| Balance December 31, 2013   | 16,596,869                                       | 16,597              |                        | 95,673                            | (30,764)              | (5,565)   | 153,957                      | 229,898                                  |
| Net income  |  |                     |                        |                                   |                       |   | 14,293                       | 14,293                                   |
| Dividends declared, \$0.36 per share  |  |                     |                        |                                   |                       |   | (4,952)                      | (4,952)                                  |
| Other comprehensive income, net of tax expense of \$1,086                       |  |                     |                        |                                   |                       | 2,017   |                              | 2,017                                    |
| Stock based compensation  |  |                     |                        | 609                               |                       |   |                              | 609                                      |
| Tax benefit from stock-based compensation                                       |  |                     |                        | 240                               |                       |   |                              | 240                                      |
| Net purchase of treasury stock from stock award and deferred compensation plans |  |                     |                        | 45                                | (288)                 |   |                              | (243)                                    |
| Common stock issued:  |  |                     |                        |                                   |                       |   |                              |  |
| Dividend Reinvestment and Stock Purchase Plan                                   | 1,159  | 1                   |                        | 31                                |                       |   |                              | 32                                       |
| Share-based awards and options exercises  | 72,856   | 73                  |                        | 1,369                             | 35                    |   |                              | 1,477                                    |
| Balance June 30, 2014   | 16,670,884                                       | \$ 16,671           | \$ 97,967              | \$ (31,017)                       | \$ (3,548)            | \$ 163,298  | \$ 243,371                   |  |

The accompanying notes are an integral part of the unaudited consolidated financial statements.

Table of Contents**BRYN MAWR BANK CORPORATION AND SUBSIDIARIES****Notes to Consolidated Financial Statements****(Unaudited)****Note 1 - Basis of Presentation**

The unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ( GAAP ). In the opinion of Bryn Mawr Bank Corporation s (the Corporation ) management, all adjustments necessary for a fair presentation of the consolidated financial position and the results of operations for the interim periods presented have been included. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto in the Corporation s Annual Report on Form 10-K for the twelve months ended December 31, 2013 (the 2013 Annual Report ).

The results of operations for the three and six months ended June 30, 2014 are not necessarily indicative of the results to be expected for the full year.

**Note 2 - Earnings Per Common Share**

Basic earnings per common share excludes dilution and is computed by dividing income available to common shareholders by the weighted-average common shares outstanding during the period. Diluted earnings per common share takes into account the potential dilution computed pursuant to the treasury stock method that could occur if stock options were exercised and converted into common stock, as well as the effect of restricted and performance shares becoming unrestricted common stock. The effects of stock options are excluded from the computation of diluted earnings per share in periods in which the effect would be anti-dilutive. All weighted average shares, actual shares and per share information in the financial statements have been adjusted retroactively for the effect of stock dividends and splits.

|   | Three Months Ended |            | Six Months Ended |            |
|---|--------------------|------------|------------------|------------|
|   | June 30,           |            | June 30,         |            |
| <i>(dollars in thousands except per share data)</i> | 2014               | 2013       | 2014             | 2013       |
| <b>Numerator:</b>                                   |                    |            |                  |            |
| Net income available to common shareholders         | \$ 7,604           | \$ 6,252   | \$ 14,293        | \$ 11,572  |
| <b>Denominator for basic earnings per share</b>     |                    |            |                  |            |
| weighted average shares outstanding                 | 13,531,155         | 13,280,624 | 13,508,311       | 13,243,289 |
| Effect of dilutive common shares                    | 304,998            | 227,150    | 304,913          | 228,782    |
| <b>Denominator for diluted earnings per share</b>   |                    |            |                  |            |
| adjusted weighted average shares outstanding        | 13,836,153         | 13,507,774 | 13,813,224       | 13,472,071 |
| Basic earnings per share                            | \$ 0.56            | \$ 0.47    | \$ 1.06          | \$ 0.87    |

|  |    |      |    |         |    |      |    |         |
|--|----|------|----|---------|----|------|----|---------|
| Diluted earnings per share   | \$ | 0.55 | \$ | 0.46    | \$ | 1.03 | \$ | 0.86    |
| Antidilutive shares excluded from computation of average dilutive earnings per share |    |      |    | 114,713 |    |      |    | 116,138 |

**Note 3 - Investment Securities**

The amortized cost and fair value of investment securities available for sale are as follows:

As of June 30, 2014

| <i>(dollars in thousands)</i>                    | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value     |
|--|-------------------|------------------------------|-------------------------------|-------------------|
| U.S. Treasury securities                         | \$ 102            | \$                           | \$ (1)                        | \$ 101            |
| Obligations of U.S. government agency securities | 63,623            | 198                          | (484)                         | 63,337            |
| Obligations of state & political subdivisions    | 35,864            | 195                          | (67)                          | 35,992            |
| Mortgage-backed securities                       | 109,045           | 2,167                        | (208)                         | 111,004           |
| Collateralized mortgage obligations              | 39,674            | 406                          | (245)                         | 39,835            |
| Other investments                                | 15,731            | 405                          | (3)                           | 16,133            |
| <b>Total</b>                                     | <b>\$ 264,039</b> | <b>\$ 3,371</b>              | <b>\$ (1,008)</b>             | <b>\$ 266,402</b> |

**Table of Contents****As of December 31, 2013**

| <i>(dollars in thousands)</i>                   | <b>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> |
|---|---------------------------|---------------------------------------|--|-----------------------|
| U.S. Treasury securities                        | \$ 102                    | \$                                    | \$ (3)                                 | \$ 99                 |
| Obligations of the U.S. government and agencies | 71,097                    | 149                                   | (1,678)                                | 69,568                |
| Obligations of state and political subdivisions | 37,140                    | 141                                   | (304)                                  | 36,977                |
| Mortgage-backed securities                      | 119,044                   | 1,392                                 | (1,073)                                | 119,363               |
| Collateralized mortgage obligations             | 44,463                    | 273                                   | (493)                                  | 44,243                |
| Other investments                               | 15,281                    | 301                                   | (24)                                   | 15,558                |
| <b>Total</b>                                    | <b>\$ 287,127</b>         | <b>\$ 2,256</b>                       | <b>\$ (3,575)</b>                      | <b>\$ 285,808</b>     |

The following tables detail the amount of investment securities available for sale that were in an unrealized loss position as of the dates indicated:

**As of June 30, 2014**

| <i>(dollars in thousands)</i>                   | <b>Less than 12</b>   |                              | <b>12 Months</b>      |                              | <b>Total</b>          |                              |
|---|-----------------------|------------------------------|-----------------------|------------------------------|-----------------------|------------------------------|
|   | <b>Months</b>         |                              | <b>or Longer</b>      |                              | <b>Total</b>          |                              |
|   | <b>Fair<br/>Value</b> | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> | <b>Unrealized<br/>Losses</b> |
| U.S. Treasury securities                        | \$                    | \$                           | \$ 101                | \$ (1)                       | \$ 101                | \$ (1)                       |
| Obligations of the U.S. government and agencies | 5,492                 | (5)                          | 28,063                | (479)                        | 33,555                | (484)                        |
| Obligations of state and political subdivisions | 4,343                 | (13)                         | 4,913                 | (54)                         | 9,256                 | (67)                         |
| Mortgage-backed securities                      | 6,112                 | (13)                         | 15,248                | (195)                        | 21,360                | (208)                        |
| Collateralized mortgage obligations             | 5,383                 | (34)                         | 8,403                 | (211)                        | 13,786                | (245)                        |
| Other investments                               | 193                   | (3)                          |                       |                              | 193                   | (3)                          |
| <b>Total</b>                                    | <b>\$ 21,523</b>      | <b>\$ (68)</b>               | <b>\$ 56,728</b>      | <b>\$ (940)</b>              | <b>\$ 78,251</b>      | <b>\$ (1,008)</b>            |

**As of December 31, 2013**

| <b>Less than 12</b> | <b>12 Months</b> | <b>Total</b> |
|---------------------|------------------|--------------|
| <b>Months</b>       | <b>or Longer</b> | <b>Total</b> |

| <i>(dollars in thousands)</i>                   | <b>Fair Value</b> | <b>Unrealized Losses</b> | <b>Fair Value</b> | <b>Unrealized Losses</b> | <b>Fair Value</b> | <b>Unrealized Losses</b> |
|---|-------------------|--------------------------|-------------------|--------------------------|-------------------|--------------------------|
| U.S. Treasury securities                        | \$ 99             | \$ (3)                   | \$                | \$                       | \$ 99             | \$ (3)                   |
| Obligations of the U.S. government and agencies | 41,201            | (1,391)                  | 5,774             | (287)                    | 46,975            | (1,678)                  |
| Obligations of state and political subdivisions | 13,020            | (233)                    | 4,543             | (71)                     | 17,563            | (304)                    |
| Mortgage-backed securities                      | 55,672            | (972)                    | 2,302             | (101)                    | 57,974            | (1,073)                  |
| Collateralized mortgage obligations             | 26,395            | (493)                    |                   |                          | 26,395            | (493)                    |
| Other investments                               | 1,494             | (24)                     |                   |                          | 1,494             | (24)                     |
| <b>Total</b>                                    | <b>\$ 137,881</b> | <b>\$ (3,116)</b>        | <b>\$ 12,619</b>  | <b>\$ (459)</b>          | <b>\$ 150,500</b> | <b>\$ (3,575)</b>        |

Management evaluates the Corporation's investment securities available for sale that are in an unrealized loss position in order to determine if the decline in market value is other than temporary. The available for sale investment portfolio includes debt securities issued by U.S. government agencies, U.S. government-sponsored agencies, state and local municipalities and other issuers. All fixed income investment securities in the Corporation's available for sale investment portfolio are rated as investment grade. Factors considered in the evaluation include the current economic climate, the length of time and the extent to which the fair value has been

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below cost, interest rates and the bond rating of each security. The unrealized losses presented in the tables above are temporary in nature and are primarily related to market interest rates rather than the underlying credit quality of the issuers. The Corporation does not believe that these unrealized losses are other-than-temporary. The Corporation does not have the intent to sell these securities prior to their maturity or the recovery of their cost bases and believes that it is more likely than not that it will not have to sell these securities prior to their maturity or the recovery of their cost bases.

As of June 30, 2014 and December 31, 2013, securities having fair values of \$92.8 million and \$94.9 million, respectively, were specifically pledged as collateral for public funds, trust deposits, the Federal Reserve Bank of Philadelphia discount window program, Federal Home Loan Bank of Pittsburgh ( FHLB ) borrowings and other purposes. The FHLB has a blanket lien on non-pledged, mortgage-related loans and securities as part of the Bank's borrowing agreement with the FHLB.

The amortized cost and fair value of investment securities available for sale as of June 30, 2014 and December 31, 2013, by contractual maturity, are shown below:

|  | June 30, 2014 |            | December 31, 2013 |            |
|--|---------------|------------|-------------------|------------|
|  | Amortized     | Fair       | Amortized         | Fair       |
| <i>(dollars in thousands)</i>            | Cost          | Value      | Cost              | Value      |
| Investment securities <sup>1</sup> :     |               |            |                   |            |
| Due in one year or less                  | \$ 16,417     | \$ 16,458  | \$ 7,859          | \$ 7,869   |
| Due after one year through five years    | 52,182        | 52,290     | 49,790            | 49,721     |
| Due after five years through ten years   | 32,149        | 31,809     | 51,793            | 50,117     |
| Due after ten years                      | 743           | 774        | 797               | 824        |
| Subtotal                                 | 101,491       | 101,331    | 110,239           | 108,531    |
| Mortgage-related securities <sup>2</sup> | 148,719       | 150,839    | 163,507           | 163,606    |
| Total                                    | \$ 250,210    | \$ 252,170 | \$ 273,746        | \$ 272,137 |

<sup>1</sup> Included in the investment portfolio, but not in the table above, are mutual funds with a fair value, as of both June 30, 2014 and December 31, 2013, of \$14.2 million and \$13.7 million, respectively, which have no stated maturity.

<sup>2</sup> Expected maturities of mortgage-related securities may differ from contractual maturities as borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

As of June 30, 2014 and December 31, 2013, the Corporation's investment securities held in trading accounts were comprised of a deferred compensation trust which is invested in marketable securities whose diversification is at the discretion of the deferred compensation plan participants.

**Note 4 - Loans and Leases****A. Loans and leases outstanding are detailed by category as follows:**



|   | <b>June 30,<br/>2014</b> | <b>December 31,<br/>2013</b> |
|---|--------------------------|------------------------------|
| Loans held for sale   | \$ 1,631                 | \$ 1,350                     |
| Real estate loans:  |                          |                              |
| Commercial mortgage   | \$ 666,924               | \$ 625,341                   |
| Home equity lines and loans   | 185,593                  | 189,571                      |
| Residential mortgage  | 310,491                  | 300,243                      |
| Construction  | 55,051                   | 46,369                       |
| <b>Total real estate loans</b>  | <b>1,218,059</b>         | <b>1,161,524</b>             |
| Commercial and industrial   | 334,474                  | 328,459                      |
| Consumer  | 18,907                   | 16,926                       |
| Leases  | 44,102                   | 40,276                       |
| <b>Total portfolio loans and leases</b>                                 | <b>1,615,542</b>         | <b>1,547,185</b>             |
| <b>Total loans and leases</b>   | <b>\$ 1,617,173</b>      | <b>\$ 1,548,535</b>          |
| Loans with predetermined rates  | \$ 896,505               | \$ 850,168                   |
| Loans with adjustable or floating rates                                 | 720,668                  | 698,367                      |
| <b>Total loans and leases</b>   | <b>\$ 1,617,173</b>      | <b>\$ 1,548,535</b>          |
| Net deferred loan origination costs included in the<br>above loan table | \$ 157                   | \$ 222                       |

**Table of Contents****B. Components of the net investment in leases are detailed as follows:**

| <i>(dollars in thousands)</i>          | <b>June 30,<br/>2014</b> | <b>December 31,<br/>2013</b> |
|--|--------------------------|------------------------------|
| Minimum lease payments receivable      | \$ 50,171                | \$ 45,866                    |
| Unearned lease income                  | (8,219)                  | (7,534)                      |
| Initial direct costs and deferred fees | 2,150                    | 1,944                        |
| <b>Total</b>                           | <b>\$ 44,102</b>         | <b>\$ 40,276</b>             |

**C. Non-Performing Loans and Leases<sup>(1)</sup>**

| <i>(dollars in thousands)</i>        | <b>June 30,<br/>2014</b> | <b>December 31,<br/>2013</b> |
|--------------------------------------|--------------------------|------------------------------|
| <b>Non-accrual loans and leases:</b> |                          |                              |
| Commercial mortgage                  | \$ 296                   | \$ 478                       |
| Home equity lines and loans          | 1,210                    | 1,262                        |
| Residential mortgage                 | 3,633                    | 4,377                        |
| Construction                         | 469                      | 830                          |
| Commercial and industrial            | 2,729                    | 3,539                        |
| Consumer                             |                          | 20                           |
| Leases                               | 51                       | 24                           |
| <b>Total</b>                         | <b>\$ 8,388</b>          | <b>\$ 10,530</b>             |

<sup>(1)</sup> *Purchased credit-impaired loans, which have been recorded at their fair values at acquisition, and which are performing, are excluded from this table, with the exception of \$143 thousand and \$238 thousand of purchased credit-impaired loans as of June 30, 2014 and December 31, 2013, respectively, which became non-performing subsequent to acquisition.*

**D. Purchased Credit-Impaired Loans**

The outstanding principal balance and related carrying amount of credit-impaired loans, for which the Bank applies ASC 310-30, *Accounting for Purchased Loans with Deteriorated Credit Quality*, to account for the interest earned, as of the dates indicated, are as follows:

| <i>(dollars in thousands)</i>  | <b>June 30,<br/>2014</b> | <b>December 31,<br/>2013</b> |
|--------------------------------|--------------------------|------------------------------|
| Outstanding principal balance  | \$ 12,975                | \$ 14,293                    |
| Carrying amount <sup>(1)</sup> | \$ 9,076                 | \$ 9,880                     |

- (1) *Includes \$188 thousand and \$293 thousand purchased credit-impaired loans as of June 30, 2014 and December 31, 2013, respectively, for which the Bank could not estimate the timing or amount of expected cash flows to be collected at acquisition, and for which no accretable yield is recognized. Additionally, the table above includes \$143 thousand and \$238 thousand of purchased credit-impaired loans as of June 30, 2014 and December 31, 2013, respectively, which became non-performing subsequent to acquisition, which are disclosed in Note 4C, above, and which also have no accretable yield.*

The following table presents changes in the accretable discount on purchased credit-impaired loans, for which the Bank applies ASC 310-30, for the six months ended June 30, 2014:

| <i>(dollars in thousands)</i>                   | <b>Accretable<br/>Discount</b> |
|---|--------------------------------|
| Balance, December 31, 2013                      | \$ 6,134                       |
| Accretion                                       | (834)                          |
| Reclassifications from nonaccretable difference | 930                            |
| Additions/adjustments                           | (123)                          |
| Disposals                                       | (2)                            |
| Balance, June 30, 2014                          | \$ 6,105                       |

**Table of Contents****E. Age Analysis of Past Due Loans and Leases**

The following tables present an aging of the Corporation's loan and lease portfolio as of the dates indicated:

|                               | Accruing Loans and Leases |                        |                        |                        |                             | Total<br>Accruing<br>Loans and<br>Leases | Nonaccrual<br>Loans<br>and<br>Leases | Total<br>Loans<br>and<br>Leases |                   |
|-------------------------------|---------------------------|------------------------|------------------------|------------------------|-----------------------------|--|--------------------------------------|---------------------------------|-------------------|
|                               | 30<br>Days<br>Past Due    | 59<br>Days<br>Past Due | 60<br>Days<br>Past Due | 89<br>Days<br>Past Due | Over 89<br>Days<br>Past Due |  |                                      |                                 | Total<br>Past Due |
| <i>(dollars in thousands)</i> |                           |                        |                        |                        |                             |  |                                      |                                 |                   |
| <b>As of June 30, 2014</b>    |                           |                        |                        |                        |                             |  |                                      |                                 |                   |
| Commercial mortgage           | \$                        |                        | \$ 402                 | \$                     | \$ 402                      | \$ 666,226                               | \$ 666,628                           | \$ 296                          | \$ 666,924        |
| Home equity lines and loans   |                           | 86                     |                        | 35                     | 121                         | 184,262                                  | 184,383                              | 1,210                           | 185,593           |
| Residential mortgage          |                           | 2,973                  |                        |                        | 2,973                       | 303,885                                  | 306,858                              | 3,633                           | 310,491           |
| Construction                  |                           |                        |                        |                        |                             | 54,582                                   | 54,582                               | 469                             | 55,051            |
| Commercial and industrial     |                           | 27                     |                        |                        | 27                          | 331,718                                  | 331,745                              | 2,729                           | 334,474           |
| Consumer                      |                           |                        |                        | 1                      | 1                           | 18,906                                   | 18,907                               |                                 | 18,907            |
| Leases                        |                           | 122                    |                        | 98                     | 220                         | 43,831                                   | 44,051                               | 51                              | 44,102            |
|                               |                           | \$ 3,208               | \$ 536                 | \$                     | \$ 3,744                    | \$ 1,603,410                             | \$ 1,607,154                         | \$ 8,388                        | \$ 1,615,542      |

|                                | Accruing Loans and Leases |                        |                        |                        |                             | Total<br>Accruing<br>Loans and<br>Leases | Nonaccrual<br>Loans<br>and<br>Leases | Total<br>Loans<br>and<br>Leases |                   |
|--------------------------------|---------------------------|------------------------|------------------------|------------------------|-----------------------------|--|--------------------------------------|---------------------------------|-------------------|
|                                | 30<br>Days<br>Past Due    | 59<br>Days<br>Past Due | 60<br>Days<br>Past Due | 89<br>Days<br>Past Due | Over 89<br>Days<br>Past Due |  |                                      |                                 | Total<br>Past Due |
| <i>(dollars in thousands)</i>  |                           |                        |                        |                        |                             |  |                                      |                                 |                   |
| <b>As of December 31, 2013</b> |                           |                        |                        |                        |                             |  |                                      |                                 |                   |
| Commercial mortgage            | \$ 241                    | \$                     | \$                     | \$                     | \$ 241                      | \$ 624,622                               | \$ 624,863                           | \$ 478                          | \$ 625,341        |
| Home equity lines and loans    |                           | 209                    |                        |                        | 209                         | 188,100                                  | 188,309                              | 1,262                           | 189,571           |
| Residential mortgage           |                           | 773                    |                        | 35                     | 808                         | 295,058                                  | 295,866                              | 4,377                           | 300,243           |
| Construction                   |                           |                        |                        |                        |                             | 45,539                                   | 45,539                               | 830                             | 46,369            |
| Commercial and industrial      |                           | 334                    |                        |                        | 334                         | 324,586                                  | 324,920                              | 3,539                           | 328,459           |
| Consumer                       |                           | 2                      |                        | 4                      | 6                           | 16,900                                   | 16,906                               | 20                              | 16,926            |
| Leases                         |                           | 60                     |                        | 60                     | 120                         | 40,132                                   | 40,252                               | 24                              | 40,276            |
|                                |                           | \$ 1,619               | \$ 99                  | \$                     | \$ 1,718                    | \$ 1,534,937                             | \$ 1,536,655                         | \$ 10,530                       | \$ 1,547,185      |

**F. Allowance for Loan and Lease Losses (the Allowance )**

The following tables detail the roll-forward of the Corporation's Allowance for the three and six months ended June 30, 2014:

### Home Equity

| <i>(dollars in thousands)</i>             | <b>Commercial<br/>Mortgage</b> | <b>Lines<br/>and<br/>Loans</b> | <b>Residential<br/>Mortgage</b> | <b>Construction</b> | <b>Commercial<br/>and<br/>Industrial</b> | <b>Consumer<br/>Leases</b> | <b>Unallocated</b> | <b>Total</b> |           |
|---|--------------------------------|--------------------------------|---------------------------------|---------------------|--|----------------------------|--------------------|--------------|-----------|
| Balance,<br>March 31, 2014                | \$ 3,971                       | \$ 2,129                       | \$ 2,318                        | \$ 867              | \$ 5,356                                 | \$ 286                     | \$ 615             | \$ 228       | \$ 15,770 |
| Charge-offs                               |                                | (57)                           |                                 |                     | (168)                                    | (39)                       | (40)               |              | (304)     |
| Recoveries                                |                                | 2                              | 8                               |                     | 53                                       | 3                          | 38                 |              | 104       |
| Provision for<br>loan and lease<br>losses | (140)                          | 520                            | 61                              | 133                 | (583)                                    | 11                         | (172)              | 70           | (100)     |
| Balance, June 30,<br>2014                 | \$ 3,831                       | \$ 2,594                       | \$ 2,387                        | \$ 1,000            | \$ 4,658                                 | \$ 261                     | \$ 441             | \$ 298       | \$ 15,470 |

### Home Equity

| <i>(dollars in thousands)</i>          | <b>Commercial<br/>Mortgage</b> | <b>Lines<br/>and<br/>Loans</b> | <b>Residential<br/>Mortgage</b> | <b>Construction</b> | <b>Commercial<br/>and<br/>Industrial</b> | <b>Consumer<br/>Leases</b> | <b>Unallocated</b> | <b>Total</b> |           |
|--|--------------------------------|--------------------------------|---------------------------------|---------------------|--|----------------------------|--------------------|--------------|-----------|
| Balance,<br>December 31,<br>2013       | \$ 3,797                       | \$ 2,204                       | \$ 2,446                        | \$ 845              | \$ 5,011                                 | \$ 259                     | \$ 604             | \$ 349       | \$ 15,515 |
| Charge-offs                            | (20)                           | (443)                          | (17)                            |                     | (169)                                    | (71)                       | (122)              |              | (842)     |
| Recoveries                             | 1                              | 2                              | 12                              |                     | 54                                       | 6                          | 72                 |              | 147       |
| Provision for loan<br>and lease losses | 53                             | 831                            | (54)                            | 155                 | (238)                                    | 67                         | (113)              | (51)         | 650       |
| Balance June 30,<br>2014               | \$ 3,831                       | \$ 2,594                       | \$ 2,387                        | \$ 1,000            | \$ 4,658                                 | \$ 261                     | \$ 441             | \$ 298       | \$ 15,470 |

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The following table details the roll-forward of the Corporation's Allowance for the three and six months ended June 30, 2013:

| <i>(dollars in thousands)</i>       | Home Equity Lines   |           |                      | Commercial and |            |          |        | Unallocated | Total     |
|-------------------------------------|---------------------|-----------|----------------------|----------------|------------|----------|--------|-------------|-----------|
|                                     | Commercial Mortgage | and Loans | Residential Mortgage | Construction   | Industrial | Consumer | Lease  |             |           |
| Balance, March 31, 2013             | \$ 4,106            | \$ 2,030  | \$ 1,829             | \$ 1,051       | \$ 4,437   | \$ 211   | \$ 525 | \$ 258      | \$ 14,447 |
| Charge-offs                         |                     | (292)     |                      | (550)          | (183)      | (32)     | (107)  |             | (1,164)   |
| Recoveries                          |                     |           | 4                    | 18             | 41         | 2        | 96     |             | 161       |
| Provision for loan and lease losses | 375                 | 371       | (60)                 | 134            |            | 37       | 37     | 106         | 1,000     |
| Balance, June 30, 2013              | \$ 4,481            | \$ 2,109  | \$ 1,773             | \$ 653         | \$ 4,295   | \$ 218   | \$ 551 | \$ 364      | \$ 14,444 |

| <i>(dollars in thousands)</i>       | Home Equity Lines   |           |                      | Commercial and |            |          |        | Unallocated | Total     |
|-------------------------------------|---------------------|-----------|----------------------|----------------|------------|----------|--------|-------------|-----------|
|                                     | Commercial Mortgage | and Loans | Residential Mortgage | Construction   | Industrial | Consumer | Lease  |             |           |
| Balance, December 31, 2012          | \$ 3,907            | \$ 1,857  | \$ 2,024             | \$ 1,019       | \$ 4,637   | \$ 189   | \$ 493 | \$ 299      | \$ 14,425 |
| Charge-offs                         |                     | (352)     |                      | (720)          | (718)      | (70)     | (134)  |             | (1,994)   |
| Recoveries                          |                     |           | 8                    | 18             | 45         | 4        | 134    |             | 209       |
| Provision for loan and lease losses | 574                 | 604       | (259)                | 336            | 331        | 95       | 58     | 65          | 1,804     |
| Balance, June 30, 2013              | \$ 4,481            | \$ 2,109  | \$ 1,773             | \$ 653         | \$ 4,295   | \$ 218   | \$ 551 | \$ 364      | \$ 14,444 |

The following table details the allocation of the Allowance by portfolio segment based on the methodology used to evaluate the loans and leases for impairment as of June 30, 2014 and December 31, 2013:

| <i>(dollars in thousands)</i>         | Home Equity Lines   |           |                      | Commercial and |            |          |       | Unallocated | Total    |
|---------------------------------------|---------------------|-----------|----------------------|----------------|------------|----------|-------|-------------|----------|
|                                       | Commercial Mortgage | and Loans | Residential Mortgage | Construction   | Industrial | Consumer | Lease |             |          |
| <b>As of June 30, 2014</b>            |                     |           |                      |                |            |          |       |             |          |
| Allowance on loans and leases:        |                     |           |                      |                |            |          |       |             |          |
| Individually evaluated for impairment | \$                  | \$ 249    | \$ 634               | \$             | \$ 843     | \$ 33    | \$    | \$          | \$ 1,759 |
|                                       | 3,747               | 2,345     | 1,753                | 1,000          | 3,815      | 228      | 441   | 298         | 13,627   |

Collectively evaluated  
for impairment

|   |    |  |  |  |  |  |  |  |    |
|---|----|--|--|--|--|--|--|--|----|
| Purchased<br>credit-impaired <sup>(1)</sup> | 84 |  |  |  |  |  |  |  | 84 |
|---|----|--|--|--|--|--|--|--|----|

|       |          |          |          |          |          |        |        |        |           |
|-------|----------|----------|----------|----------|----------|--------|--------|--------|-----------|
| Total | \$ 3,831 | \$ 2,594 | \$ 2,387 | \$ 1,000 | \$ 4,658 | \$ 261 | \$ 441 | \$ 298 | \$ 15,470 |
|-------|----------|----------|----------|----------|----------|--------|--------|--------|-----------|

**As of December 31,  
2013**

Allowance on loans and  
leases:

|  |    |        |        |    |        |       |    |    |          |
|--|----|--------|--------|----|--------|-------|----|----|----------|
| Individually evaluated<br>for impairment | \$ | \$ 121 | \$ 814 | \$ | \$ 532 | \$ 52 | \$ | \$ | \$ 1,519 |
|--|----|--------|--------|----|--------|-------|----|----|----------|

|  |       |       |       |     |       |     |     |     |        |
|--|-------|-------|-------|-----|-------|-----|-----|-----|--------|
| Collectively evaluated<br>for impairment | 3,797 | 2,083 | 1,632 | 845 | 4,479 | 207 | 604 | 349 | 13,996 |
|--|-------|-------|-------|-----|-------|-----|-----|-----|--------|

|   |  |  |  |  |  |  |  |  |  |
|---|--|--|--|--|--|--|--|--|--|
| Purchased<br>credit-impaired <sup>(1)</sup> |  |  |  |  |  |  |  |  |  |
|---|--|--|--|--|--|--|--|--|--|

|       |          |          |          |        |          |        |        |        |           |
|-------|----------|----------|----------|--------|----------|--------|--------|--------|-----------|
| Total | \$ 3,797 | \$ 2,204 | \$ 2,446 | \$ 845 | \$ 5,011 | \$ 259 | \$ 604 | \$ 349 | \$ 15,515 |
|-------|----------|----------|----------|--------|----------|--------|--------|--------|-----------|

<sup>(1)</sup> *Purchased credit-impaired loans are evaluated for impairment on an individual basis.*

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The following table details the carrying value for loans and leases by portfolio segment based on the methodology used to evaluate the loans and leases for impairment as of June 30, 2014 and December 31, 2013:

| <i>(dollars in thousands)</i>            | <b>Home Equity</b> |                   |                    | <b>Commercial</b>   |                   |                  |                  |                     |
|--|--------------------|-------------------|--------------------|---------------------|-------------------|------------------|------------------|---------------------|
|  | <b>Commercial</b>  | <b>and</b>        | <b>Residential</b> | <b>and</b>          | <b>Industrial</b> | <b>Consumer</b>  | <b>Leases</b>    | <b>Total</b>        |
|  | <b>Mortgage</b>    | <b>Loans</b>      | <b>Mortgage</b>    | <b>Construction</b> | <b>and</b>        | <b>Leases</b>    |                  |                     |
| <b>As of June 30, 2014</b>               |                    |                   |                    |                     |                   |                  |                  |                     |
| Carrying value of loans and leases:      |                    |                   |                    |                     |                   |                  |                  |                     |
| Individually evaluated for impairment    | \$ 153             | \$ 1,434          | \$ 9,453           | \$ 693              | \$ 3,892          | \$ 33            | \$               | \$ 15,658           |
| Collectively evaluated for impairment    | 658,101            | 184,145           | 301,006            | 54,333              | 330,247           | 18,874           | 44,102           | 1,590,808           |
| Purchased credit-impaired <sup>(1)</sup> | 8,670              | 14                | 32                 | 25                  | 335               |                  |                  | 9,076               |
| <b>Total</b>                             | <b>\$ 666,924</b>  | <b>\$ 185,593</b> | <b>\$ 310,491</b>  | <b>\$ 55,051</b>    | <b>\$ 334,474</b> | <b>\$ 18,907</b> | <b>\$ 44,102</b> | <b>\$ 1,615,542</b> |
| <b>As of December 31, 2013</b>           |                    |                   |                    |                     |                   |                  |                  |                     |
| Carrying value of loans and leases:      |                    |                   |                    |                     |                   |                  |                  |                     |
| Individually evaluated for impairment    | \$ 236             | \$ 1,428          | \$ 9,860           | \$ 1,172            | \$ 4,758          | \$ 52            | \$               | \$ 17,506           |
| Collectively evaluated for impairment    | 616,077            | 188,128           | 290,345            | 44,715              | 323,384           | 16,874           | 40,276           | 1,519,799           |
| Purchased credit-impaired <sup>(1)</sup> | 9,028              | 15                | 38                 | 482                 | 317               |                  |                  | 9,880               |
| <b>Total</b>                             | <b>\$ 625,341</b>  | <b>\$ 189,571</b> | <b>\$ 300,243</b>  | <b>\$ 46,369</b>    | <b>\$ 328,459</b> | <b>\$ 16,926</b> | <b>\$ 40,276</b> | <b>\$ 1,547,185</b> |

<sup>(1)</sup> *Purchased credit-impaired loans are evaluated for impairment on an individual basis.*

As part of the process of determining the Allowance for the different segments of the loan and lease portfolio, Management considers certain credit quality indicators. For the commercial mortgage, construction and commercial and industrial loan segments, periodic reviews of the individual loans are performed by both in-house staff as well as external loan reviewers. The result of these reviews is reflected in the risk grade assigned to each loan. These internally assigned grades are as follows:



Pass Loans considered satisfactory with no indications of deterioration.

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

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

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

In addition, for the remaining segments of the loan and lease portfolio, which include residential mortgage, home equity lines and loans, consumer, and leases, the credit quality indicator used to determine this component of the Allowance is based on performance status.

The following tables detail the carrying value of loans and leases by portfolio segment based on the credit quality indicators used to determine the Allowance as of June 30, 2014 and December 31, 2013:

**Credit Risk Profile by Internally Assigned Grade**

| <i>(dollars in thousands)</i> | <b>Commercial Mortgage</b> |                          | <b>Construction</b>  |                          | <b>Commercial and Industrial</b> |                          | <b>Total</b>         |                          |
|-------------------------------|----------------------------|--------------------------|----------------------|--------------------------|----------------------------------|--------------------------|----------------------|--------------------------|
|                               | <b>June 30, 2014</b>       | <b>December 31, 2013</b> | <b>June 30, 2014</b> | <b>December 31, 2013</b> | <b>June 30, 2014</b>             | <b>December 31, 2013</b> | <b>June 30, 2014</b> | <b>December 31, 2013</b> |
| Pass                          | \$ 664,729                 | \$ 620,227               | \$ 54,583            | \$ 43,812                | \$ 327,875                       | \$ 320,211               | \$ 1,047,187         | \$ 984,250               |
| Special Mention               |                            | 2,793                    |                      |                          | 110                              | 387                      | 110                  | 3,180                    |
| Substandard                   | 2,195                      | 2,321                    | 468                  | 2,557                    | 6,489                            | 7,861                    | 9,152                | 12,739                   |
| Total                         | \$ 666,924                 | \$ 625,341               | \$ 55,051            | \$ 46,369                | \$ 334,474                       | \$ 328,459               | \$ 1,056,449         | \$ 1,000,169             |

**Table of Contents****Credit Risk Profile by Payment Activity**

| <i>(dollars in thousands)</i> | <b>Residential Mortgage</b> |                          | <b>Home Equity Lines and Loans</b> |                          | <b>Consumer</b>      |                          | <b>Leases</b>        |                          | <b>Total</b>         |                          |
|-------------------------------|-----------------------------|--------------------------|------------------------------------|--------------------------|----------------------|--------------------------|----------------------|--------------------------|----------------------|--------------------------|
|                               | <b>June 30, 2014</b>        | <b>December 31, 2013</b> | <b>June 30, 2014</b>               | <b>December 31, 2013</b> | <b>June 30, 2014</b> | <b>December 31, 2013</b> | <b>June 30, 2014</b> | <b>December 31, 2013</b> | <b>June 30, 2014</b> | <b>December 31, 2013</b> |
| Performing                    | \$ 306,858                  | \$ 295,866               | \$ 184,383                         | \$ 188,309               | \$ 18,907            | \$ 16,906                | \$ 44,051            | \$ 40,252                | \$ 554,199           | \$ 541,333               |
| Non-performing                | 3,633                       | 4,377                    | 1,210                              | 1,262                    |                      | 20                       | 51                   | 24                       | 4,894                | 5,683                    |
| <b>Total</b>                  | <b>\$ 310,491</b>           | <b>\$ 300,243</b>        | <b>\$ 185,593</b>                  | <b>\$ 189,571</b>        | <b>\$ 18,907</b>     | <b>\$ 16,926</b>         | <b>\$ 44,102</b>     | <b>\$ 40,276</b>         | <b>\$ 559,093</b>    | <b>\$ 547,016</b>        |

**G. Troubled Debt Restructurings ( TDRs ):**

The restructuring of a loan is considered a troubled debt restructuring if both of the following conditions are met: (i) the borrower is experiencing financial difficulties, and (ii) the creditor has granted a concession. The most common concessions granted include one or more modifications to the terms of the debt, such as (a) a reduction in the interest rate for the remaining life of the debt, (b) an extension of the maturity date at an interest rate lower than the current market rate for new debt with similar risk, (c) a temporary period of interest-only payments, (d) a reduction in the contractual payment amount for either a short period or remaining term of the loan, and (e) for leases, a reduced lease payment. A less common concession granted is the forgiveness of a portion of the principal.

The determination of whether a borrower is experiencing financial difficulties takes into account not only the current financial condition of the borrower, but also the potential financial condition of the borrower, were a concession not granted. Similarly, the determination of whether a concession has been granted is very subjective in nature. For example, simply extending the term of a loan at its original interest rate or even at a higher interest rate could be interpreted as a concession unless the borrower could readily obtain similar credit terms from a different lender.

The following table presents the balance of TDRs as of the indicated dates:

| <i>(dollars in thousands)</i>                   | <b>June 30, 2014</b> | <b>December 31, 2013</b> |
|---|----------------------|--------------------------|
| TDRs included in nonperforming loans and leases | \$ 1,597             | \$ 1,699                 |
| TDRs in compliance with modified terms          | 7,487                | 7,277                    |
| <b>Total TDRs</b>                               | <b>\$ 9,084</b>      | <b>\$ 8,976</b>          |

The following tables present information regarding loan and lease modifications categorized as TDRs for the three and six months ended June 30, 2014:

| <i>(dollars in thousands)</i> | For the Three Months Ended June 30, 2014 |                                       |  |
|-------------------------------|--|---------------------------------------|--|
|                               | Number of Contracts                      | Pre-Modification Outstanding Recorded | Post-Modification Outstanding Recorded |
|                               |  |                                       |  |

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|                           |   | Investment | Investment |
|---------------------------|---|------------|------------|
| Commercial and industrial | 1 | \$ 246     | \$ 255     |
| Total                     | 1 | \$ 246     | \$ 255     |

For the Six Months Ended June 30, 2014

| <i>(dollars in thousands)</i> | Number of<br>Contracts | Pre-Modification                   | Post-Modification                  |
|-------------------------------|------------------------|------------------------------------|------------------------------------|
|                               |                        | Outstanding Recorded<br>Investment | Outstanding Recorded<br>Investment |
| Residential mortgage          | 2                      | \$ 392                             | \$ 394                             |
| Home equity lines and loans   | 1                      | 70                                 | 70                                 |
| Commercial and industrial     | 1                      | 246                                | 255                                |
| Total                         | 4                      | \$ 708                             | \$ 719                             |

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The following tables present information regarding the types of loan and lease modifications made for the three and six months ended June 30, 2014:

| Number of Contracts for the Three Months Ended June 30, 2014 |                         |                        |  |   |  |                               |
|--|-------------------------|------------------------|--|---|--|-------------------------------|
|  | Interest Rate<br>Change | Loan Term<br>Extension | Interest Rate<br>Change<br>and<br>Term Extension | Interest Rate<br>Change and/or<br>Interest-Only<br>Period | Contractual<br>Payment<br>Reduction<br>(Leases only) | Forgiveness<br>of<br>Interest |
| Commercial and industrial                                    |                         |                        |  | 1   |  |                               |
| Total  |                         |                        |  | 1   |  |                               |

| Number of Contracts for the Six Months Ended June 30, 2014 |                         |                        |  |   |  |                               |
|--|-------------------------|------------------------|--|---|--|-------------------------------|
|  | Interest Rate<br>Change | Loan Term<br>Extension | Interest Rate<br>Change<br>and<br>Term Extension | Interest Rate<br>Change and/or<br>Interest-Only<br>Period | Contractual<br>Payment<br>Reduction<br>(Leases only) | Forgiveness<br>of<br>Interest |
| Residential mortgage                                       |                         |                        |  | 2   |  |                               |
| Home equity lines and loans                                |                         | 1                      |  |   |  |                               |
| Commercial and industrial                                  |                         |                        |  | 1   |  |                               |
| Total  |                         | 1                      |  | 3   |  |                               |

During the three and six months ended June 30, 2014, there were no defaults of loans or leases that had been previously modified to troubled debt restructurings.

**H. Impaired Loans**

The following tables detail the recorded investment and principal balance of impaired loans by portfolio segment, their related Allowance and interest income recognized as of the dates or for the periods indicated:

|  | Recorded<br>Investment <sup>(2)</sup> | Principal<br>Balance | Related<br>Allowance | Average<br>Principal<br>Balance | Interest<br>Income<br>Recognized | Cash-Basis<br>Interest<br>Income<br>Recognized |
|--|---------------------------------------|----------------------|----------------------|---------------------------------|----------------------------------|--|
| <i>(dollars in thousands)</i>                            |                                       |                      |                      |                                 |                                  |  |
| <b>As of or for the three months ended June 30, 2014</b> |                                       |                      |                      |                                 |                                  |  |
| Impaired loans with related Allowance:                   |                                       |                      |                      |                                 |                                  |  |
| Home equity lines and loans                              | \$ 501                                | \$ 560               | \$ 249               | \$ 581                          | \$ 2                             | \$   |
| Residential mortgage                                     | 4,638                                 | 4,652                | 634                  | 4,711                           | 31                               |  |
| Commercial and industrial                                | 3,172                                 | 3,448                | 843                  | 3,484                           | 3                                |  |
| Consumer   | 32                                    | 33                   | 33                   | 33                              |                                  |  |

|   |    |        |    |        |    |       |    |        |    |    |    |
|---|----|--------|----|--------|----|-------|----|--------|----|----|----|
| Total   | \$ | 8,343  | \$ | 8,693  | \$ | 1,759 | \$ | 8,809  | \$ | 36 | \$ |
| Impaired loans without related Allowance <sup>(1) (3)</sup> : |    |        |    |        |    |       |    |        |    |    |    |
| Commercial mortgage   | \$ | 153    | \$ | 154    | \$ |       | \$ | 190    | \$ |    | \$ |
| Home equity lines and loans                                   |    | 933    |    | 943    |    |       |    | 1,018  |    | 1  |    |
| Residential mortgage  |    | 4,815  |    | 5,166  |    |       |    | 5,467  |    | 42 |    |
| Construction  |    | 693    |    | 1,654  |    |       |    | 1,697  |    | 2  |    |
| Commercial and industrial                                     |    | 721    |    | 725    |    |       |    | 742    |    | 2  |    |
| Total   | \$ | 7,315  | \$ | 8,642  | \$ |       | \$ | 9,114  | \$ | 47 | \$ |
| Grand total   | \$ | 15,658 | \$ | 17,335 | \$ | 1,759 | \$ | 17,923 | \$ | 83 | \$ |

- (1) *The table above does not include the recorded investment of \$74 thousand of impaired leases without a related Allowance.*
- (2) *Recorded investment equals principal balance less partial charge-offs and interest payments on non-performing loans that have been applied to principal.*
- (3) *This table excludes all purchased credit-impaired loans, which are discussed in Note 4D, above.*

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|   | <b>Recorded<br/>Investment<sup>(2)</sup></b> | <b>Principal<br/>Balance</b> | <b>Related<br/>Allowance</b> | <b>Average<br/>Principal<br/>Balance</b> | <b>Interest<br/>Income<br/>Recognized</b> | <b>Cash-Basis<br/>Interest<br/>Income<br/>Recognized</b> |
|---|--|------------------------------|------------------------------|--|---|--|
| <i>(dollars in thousands)</i>                                 |  |                              |                              |  |   |  |
| <b>As of or for the six months ended<br/>June 30, 2014</b>    |  |                              |                              |  |   |  |
| Impaired loans with related Allowance:                        |  |                              |                              |  |   |  |
| Home equity lines and loans                                   | \$ 501                                       | \$ 560                       | \$ 249                       | \$ 584                                   | \$ 4                                      | \$   |
| Residential mortgage  | 4,638  | 4,652                        | 634                          | 4,713                                    | 62  |  |
| Commercial and industrial                                     | 3,172  | 3,448                        | 843                          | 3,503                                    | 7   |  |
| Consumer  | 32   | 33                           | 33                           | 33                                       | 1   |  |
| <b>Total</b>  | <b>\$ 8,343</b>                              | <b>\$ 8,693</b>              | <b>\$ 1,759</b>              | <b>\$ 8,833</b>                          | <b>\$ 74</b>                              | <b>\$</b>  |
| Impaired loans without related Allowance <sup>(1) (3)</sup> : |  |                              |                              |  |   |  |
| Commercial mortgage   | \$ 153                                       | \$ 154                       | \$                           | \$ 190                                   | \$  | \$   |
| Home equity lines and loans                                   | 933  | 943                          |                              | 1,020                                    | 2   |  |
| Residential mortgage  | 4,815  | 5,166                        |                              | 5,468                                    | 83  |  |
| Construction  | 693  | 1,654                        |                              | 1,710                                    | 3   |  |
| Commercial and industrial                                     | 721  | 725                          |                              | 750                                      | 4   |  |
| <b>Total</b>  | <b>\$ 7,315</b>                              | <b>\$ 8,642</b>              | <b>\$</b>                    | <b>\$ 9,138</b>                          | <b>\$ 92</b>                              | <b>\$</b>  |
| <b>Grand total</b>  | <b>\$ 15,658</b>                             | <b>\$ 17,335</b>             | <b>\$ 1,759</b>              | <b>\$ 17,971</b>                         | <b>\$ 166</b>                             | <b>\$</b>  |

(1) The table above does not include the recorded investment of \$74 thousand of impaired leases without a related Allowance.

(2) Recorded investment equals principal balance less partial charge-offs and interest payments on non-performing loans that have been applied to principal.

(3) This table excludes all purchased credit-impaired loans, which are discussed in Note 4D, above.

|  | <b>Recorded<br/>Investment<sup>(2)</sup></b> | <b>Principal<br/>Balance</b> | <b>Related<br/>Allowance</b> | <b>Average<br/>Principal<br/>Balance</b> | <b>Interest<br/>Income<br/>Recognized</b> | <b>Cash-Basis<br/>Interest<br/>Income<br/>Recognized</b> |
|--|--|------------------------------|------------------------------|--|---|--|
| <i>(dollars in thousands)</i>                                |  |                              |                              |  |   |  |
| <b>As of or for the three months ended<br/>June 30, 2013</b> |  |                              |                              |  |   |  |
| Impaired loans with related Allowance:                       |  |                              |                              |  |   |  |
| Commercial mortgage  | \$ 181                                       | \$ 190                       | \$ 25                        | \$ 192                                   | \$  | \$   |
| Home equity lines and loans                                  | 715  | 762                          | 207                          | 767                                      | 7   |  |
| Residential mortgage   | 4,454  | 4,430                        | 388                          | 4,234                                    | 29  |  |
| Commercial and industrial                                    | 2,560  | 2,639                        | 466                          | 2,670                                    | 15  |  |
| Consumer   | 5  | 5                            | 5                            | 7  |   |  |

|   |    |        |    |        |    |       |    |        |    |     |    |
|---|----|--------|----|--------|----|-------|----|--------|----|-----|----|
| Total   | \$ | 7,915  | \$ | 8,026  | \$ | 1,091 | \$ | 7,870  | \$ | 51  | \$ |
| Impaired loans without related Allowance <sup>(1) (3)</sup> : |    |        |    |        |    |       |    |        |    |     |    |
| Commercial mortgage   | \$ | 342    | \$ | 347    | \$ |       | \$ | 377    | \$ | 6   | \$ |
| Home equity lines and loans                                   |    | 1,230  |    | 1,228  |    |       |    | 1,328  |    | 10  |    |
| Residential mortgage  |    | 4,696  |    | 4,747  |    |       |    | 5,026  |    | 50  |    |
| Construction  |    | 2,418  |    | 3,380  |    |       |    | 3,536  |    | 8   |    |
| Commercial and industrial                                     |    | 1,663  |    | 1,863  |    |       |    | 1,863  |    |     |    |
| Total   | \$ | 10,349 | \$ | 11,565 | \$ |       | \$ | 12,130 | \$ | 74  | \$ |
| Grand total   | \$ | 18,264 | \$ | 19,591 | \$ | 1,091 | \$ | 20,000 | \$ | 125 | \$ |

- (1) *The table above does not include the recorded investment of \$80 thousand of impaired leases without a related Allowance.*
- (2) *Recorded investment equals principal balance less partial charge-offs and interest payments on non-performing loans that have been applied to principal.*
- (3) *This table excludes all purchased credit-impaired loans, which are discussed in Note 4D, above.*

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|   | <b>Recorded<br/>Investment<sup>(2)</sup></b> | <b>Principal<br/>Balance</b> | <b>Related<br/>Allowance</b> | <b>Average<br/>Principal<br/>Balance</b> | <b>Interest<br/>Income<br/>Recognized</b> | <b>Cash-Basis<br/>Interest<br/>Income<br/>Recognized</b> |
|---|--|------------------------------|------------------------------|--|---|--|
| <i>(dollars in thousands)</i>                                 |  |                              |                              |  |   |  |
| <b>As of or for the six months ended<br/>June 30, 2013</b>    |  |                              |                              |  |   |  |
| Impaired loans with related Allowance:                        |  |                              |                              |  |   |  |
| Commercial mortgage   | \$ 181                                       | \$ 190                       | \$ 25                        | \$ 192                                   | \$  | \$   |
| Home equity lines and loans                                   | 715  | 762                          | 207                          | 777                                      | 14  |  |
| Residential mortgage  | 4,454  | 4,430                        | 388                          | 4,339                                    | 59  |  |
| Commercial and industrial                                     | 2,560  | 2,639                        | 466                          | 2,677                                    | 33  |  |
| Consumer  | 5  | 5                            | 5                            | 8  |   |  |
| <b>Total</b>  | <b>\$ 7,915</b>                              | <b>\$ 8,026</b>              | <b>\$ 1,091</b>              | <b>\$ 7,993</b>                          | <b>\$ 106</b>                             | <b>\$</b>  |
| Impaired loans without related Allowance <sup>(1) (3)</sup> : |  |                              |                              |  |   |  |
| Commercial mortgage   | \$ 342                                       | \$ 347                       | \$                           | \$ 379                                   | \$ 12                                     | \$   |
| Home equity lines and loans                                   | 1,230  | 1,228                        |                              | 1,331                                    | 22  |  |
| Residential mortgage  | 4,696  | 4,747                        |                              | 5,025                                    | 122                                       |  |
| Construction  | 2,418  | 3,380                        |                              | 3,679                                    | 18  |  |
| Commercial and industrial                                     | 1,663  | 1,863                        |                              | 1,863                                    | 1   |  |
| <b>Total</b>  | <b>\$ 10,349</b>                             | <b>\$ 11,565</b>             | <b>\$</b>                    | <b>\$ 12,277</b>                         | <b>\$ 175</b>                             | <b>\$</b>  |
| <b>Grand total</b>  | <b>\$ 18,264</b>                             | <b>\$ 19,591</b>             | <b>\$ 1,091</b>              | <b>\$ 20,270</b>                         | <b>\$ 281</b>                             | <b>\$</b>  |

(1) The table above does not include the recorded investment of \$80 thousand of impaired leases without a related Allowance.

(2) Recorded investment equals principal balance less partial charge-offs and interest payments on non-performing loans that have been applied to principal.

(3) This table excludes all purchased credit-impaired loans, which are discussed in Note 4D, above.

|  | <b>Recorded<br/>Investment<sup>(2)</sup></b> | <b>Principal<br/>Balance</b> | <b>Related<br/>Allowance</b> |
|--|--|------------------------------|------------------------------|
| <i>(dollars in thousands)</i>                                |  |                              |                              |
| <b>As of December 31, 2013</b>                               |  |                              |                              |
| Impaired loans with related allowance:                       |  |                              |                              |
| Home equity lines and loans                                  | \$ 277                                       | \$ 279                       | \$ 121                       |
| Residential mortgage   | 5,297  | 5,312                        | 814                          |
| Commercial and industrial                                    | 2,985  | 3,100                        | 532                          |
| Consumer   | 52   | 54                           | 52                           |
| <b>Total</b>   | <b>8,611</b>                                 | <b>8,745</b>                 | <b>1,519</b>                 |
| Impaired loans <sup>(1),(3)</sup> without related allowance: |  |                              |                              |
| Commercial mortgage  | 236  | 237                          |                              |



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|                             |           |           |          |
|-----------------------------|-----------|-----------|----------|
| Home equity lines and loans | 1,151     | 1,159     |          |
| Residential mortgage        | 4,563     | 4,911     |          |
| Construction                | 1,172     | 2,134     |          |
| Commercial and industrial   | 1,773     | 1,954     |          |
| Total                       | 8,895     | 10,395    |          |
| Grand total                 | \$ 17,506 | \$ 19,140 | \$ 1,519 |

- (1) *The table above does not include the recorded investment of \$63 thousand of impaired leases without a related Allowance.*
- (2) *Recorded investment equals principal balance less partial charge-offs and interest payments on non-performing loans that have been applied to principal.*
- (3) *This table excludes all purchased credit-impaired loans, which are discussed in Note 4D, above.*

**Table of Contents****Note 5 - Deposits**

The following table details the components of deposits:

| <i>(dollars in thousands)</i>          | <b>June 30, 2014</b> | <b>December 31, 2013</b> |
|--|----------------------|--------------------------|
| Savings accounts                       | \$ 145,312           | \$ 135,240               |
| Interest-bearing checking accounts     | 263,247              | 266,787                  |
| Market-rate accounts                   | 559,070              | 544,310                  |
| Wholesale non-maturity deposits        | 41,840               | 42,936                   |
| Wholesale time deposits                | 50,152               | 34,640                   |
| Time deposits                          | 123,572              | 140,794                  |
| <b>Total interest-bearing deposits</b> | <b>1,183,193</b>     | <b>1,164,707</b>         |
| Non-interest-bearing deposits          | 436,739              | 426,640                  |
| <b>Total deposits</b>                  | <b>\$ 1,619,932</b>  | <b>\$ 1,591,347</b>      |

**Note 6 - Borrowings****A. Short-term borrowings**

The Corporation's short-term borrowings (original maturity of one year or less), which consist of a revolving line of credit with a correspondent bank, funds obtained from overnight repurchase agreements with commercial customers, FHLB advances with original maturities of one year or less and overnight fed funds, are detailed below.

A summary of short-term borrowings is as follows:

| <i>(dollars in thousands)</i>      | <b>June 30, 2014</b> | <b>December 31, 2013</b> |
|------------------------------------|----------------------|--------------------------|
| Overnight fed funds                | \$                   | \$                       |
| Revolving line of credit           |                      |                          |
| Short-term FHLB advances           |                      |                          |
| Repurchase agreements              | 13,320               | 10,891                   |
| <b>Total short-term borrowings</b> | <b>\$ 13,320</b>     | <b>\$ 10,891</b>         |

The following table sets forth information concerning short-term borrowings:

| <i>(dollars in thousands)</i> | <b>Three Months Ended June 30, Six Months Ended June 30,</b> |             |             |             |
|-------------------------------|--|-------------|-------------|-------------|
|                               | <b>2014</b>  | <b>2013</b> | <b>2014</b> | <b>2013</b> |
| Balance at period-end         | \$ 13,320  | \$ 71,768   | \$ 13,320   | \$ 71,768   |

|   |        |        |        |        |
|---|--------|--------|--------|--------|
| Maximum amount outstanding at any month-end   | 28,017 | 71,768 | 28,017 | 71,768 |
| Average balance outstanding during the period | 17,220 | 13,358 | 15,167 | 12,672 |
| Weighted-average interest rate:               |        |        |        |        |
| As of period-end                              | 0.10%  | 0.23%  | 0.10%  | 0.23%  |
| Paid during the period                        | 0.12%  | 0.12%  | 0.11%  | 0.13%  |

### B. Long-term FHLB Advances and Other Borrowings

The Corporation's long-term FHLB advances and other borrowings consist of advances from the FHLB with original maturities of greater than one year and an adjustable-rate commercial loan from a correspondent bank.

The following table presents the remaining periods until maturity of the long-term FHLB advances and other borrowings:

| <i>(dollars in thousands)</i>     | <b>June 30, 2014</b> | <b>December 31, 2013</b> |
|-----------------------------------|----------------------|--------------------------|
| Within one year                   | \$ 18,675            | \$ 3,917                 |
| Over one year through five years  | 209,457              | 196,727                  |
| Over five years through ten years | 5,000                | 5,000                    |
| Total                             | \$ 233,132           | \$ 205,644               |

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The following table presents rate and maturity information on long-term FHLB advances and other borrowings:

| <i>(dollars in thousands)</i>    | Maturity Range <sup>(1)</sup> |          | Weighted<br>Average<br>Rate | Coupon Rate |       | Balance       |                   |
|----------------------------------|-------------------------------|----------|-----------------------------|-------------|-------|---------------|-------------------|
|                                  | From                          | To       |                             | From        | To    | June 30, 2014 | December 31, 2013 |
| Fixed amortizing                 | 04/09/15                      | 04/09/15 | 3.57%                       | 3.57%       | 3.57% | \$ 1,325      | \$ 2,102          |
| Adjustable amortizing            | 12/31/16                      | 12/31/16 | 3.25%                       | 3.25%       | 3.25% | 5,375         | 7,050             |
| Bullet maturity fixed rate       | 03/23/15                      | 05/20/20 | 1.41%                       | 0.58%       | 2.41% | 160,000       | 140,000           |
| Bullet maturity variable rate    | 06/25/15                      | 11/28/17 | 0.40%                       | 0.25%       | 0.54% | 45,000        | 35,000            |
| Convertible-fixed <sup>(2)</sup> | 01/03/18                      | 08/20/18 | 2.95%                       | 2.58%       | 3.50% | 21,432        | 21,492            |
| Total                            |                               |          |                             |             |       | \$ 233,132    | \$ 205,644        |

(1) Maturity range refers to June 30, 2014 balances.

(2) FHLB advances whereby the FHLB has the option, at predetermined times, to convert the fixed interest rate to an adjustable interest rate indexed to the London Interbank Offered Rate ( LIBOR ). The Corporation has the option to prepay these advances, without penalty, if the FHLB elects to convert the interest rate to an adjustable rate. As of June 30, 2014, substantially all the FHLB advances with this convertible feature are subject to conversion in fiscal 2014. These advances are included in the maturity ranges in which they mature, rather than the period in which they are subject to conversion.

**C. Other Borrowings Information**

As of June 30, 2014 the Corporation had a maximum borrowing capacity with the FHLB of approximately \$866.5 million, of which the unused capacity was \$624.2 million. In addition, there were unused capacities of \$64.0 million in overnight federal funds line, \$84.0 million of Federal Reserve Discount Window borrowings and \$3.0 million in a revolving line of credit from a correspondent bank as of June 30, 2014. In connection with its FHLB borrowings, the Corporation is required to hold the capital stock of the FHLB. The amount of FHLB capital stock held was \$12.8 million at June 30, 2014, and \$11.7 million at December 31, 2013. The carrying amount of the FHLB capital stock approximates its redemption value.

**Note 7 - Derivatives and Hedging Activities**

In December, 2012, the Corporation entered into a forward-starting interest rate swap to hedge the cash flows of a \$15 million floating-rate FHLB borrowing. The interest rate swap involves the exchange of the Corporation's floating rate interest payments on the underlying principal amount. This swap was designated, and qualified, for cash-flow hedge accounting. The term of the swap begins November 30, 2015 and ends November 28, 2022. For derivative instruments that are designated and qualify as hedging instruments, the effective portion of gains or losses is reported as a component of other comprehensive income, and is subsequently reclassified into earnings as an adjustment to interest expense in the periods in which the hedged forecasted transaction affects earnings.

The following table details the Corporation's derivative positions as of the balance sheet dates indicated:

**As of June 30, 2014:**

*(dollars in thousands)*

| Notional<br>Amount | Trade Date | Effective<br>Date | Maturity<br>Date | Receive (Variable)<br>Index | Current<br>Projected<br>Receive Rate | Pay Fixed<br>Swap Rate | Fair Value of<br>Asset<br>(Liability) |
|--------------------|------------|-------------------|------------------|-----------------------------|--------------------------------------|------------------------|---------------------------------------|
| \$ 15,000          | 12/13/2012 | 11/30/2015        | 11/28/2022       | US 3-Month LIBOR            | 2.828%                               | 2.376%                 | \$ 420                                |

**As of December 31, 2013:**

*(dollars in thousands)*

| Notional<br>Amount | Trade Date | Effective<br>Date | Maturity<br>Date | Receive (Variable)<br>Index | Current<br>Projected<br>Receive Rate | Pay Fixed<br>Swap Rate | Fair Value of<br>Asset<br>(Liability) |
|--------------------|------------|-------------------|------------------|-----------------------------|--------------------------------------|------------------------|---------------------------------------|
| \$ 15,000          | 12/13/2012 | 11/30/2015        | 11/28/2022       | US 3-Month LIBOR            | 3.597%                               | 2.376%                 | \$ 1,142                              |

For each of the three and six month periods ended June 30, 2014 and 2013, there were no reclassifications of the interest-rate swap's fair value from other comprehensive income to earnings.

**Table of Contents****Note 8 - Stock-Based Compensation****A. General Information**

The Corporation permits the issuance of stock options, dividend equivalents, performance awards, stock appreciation rights, restricted stock and/or restricted stock units to employees and directors of the Corporation under several plans. The terms and conditions of awards under the plans are determined by the Corporation's Compensation Committee.

Prior to April 25, 2007, all shares authorized for grant as stock-based compensation were limited to grants of stock options. On April 25, 2007, the shareholders approved the Corporation's 2007 Long-Term Incentive Plan (the 2007 LTIP) under which a total of 428,996 shares of the Corporation's common stock were made available for award grants. On April 28, 2010, the shareholders approved the Corporation's 2010 Long Term Incentive Plan (2010 LTIP) under which a total of 445,002 shares of the Corporation's common stock were made available for award grants.

The equity awards granted under the 2007 and 2010 LTIPs were authorized to be in the form of, among others, options to purchase the Corporation's common stock, restricted stock awards or units (RSAs or RSUs) and performance stock awards or units (PSAs or PSUs).

RSAs and RSUs have a restriction based on the passage of time and may also have a restriction based on non-market-related performance criteria. The fair value of the RSAs and RSUs is based on the closing price on the day preceding the date of the grant.

The PSAs and PSUs have a restriction based on the passage of time, but also have a restriction based on performance criteria related to the Corporation's total shareholder return relative to the performance of the community bank index for the respective period. The amount of PSAs or PSUs earned will not exceed 100% of the PSAs or PSUs awarded. The fair value of the PSAs and PSUs is calculated using the Monte Carlo Simulation method.

**B. Stock Options**

Stock-based compensation cost is measured at the grant date, based on the fair value of the award and is recognized as an expense over the vesting period. The fair value of stock option grants is determined using the Black-Scholes pricing model. The assumptions necessary for the calculation of the fair value are expected life of options, annual volatility of stock price, risk-free interest rate and annual dividend yield.

The following table provides information about options outstanding for the three months ended June 30, 2014:

|                                     | Shares   | Weighted<br>Average<br>Exercise Price | Weighted<br>Average Grant<br>Date Fair<br>Value |
|-------------------------------------|----------|---------------------------------------|---|
| Options outstanding, March 31, 2014 | 585,196  | \$ 20.77                              | \$ 4.70   |
| Granted                             |          | \$                                    | \$  |
| Forfeited                           |          | \$                                    | \$  |
| Expired                             |          | \$                                    | \$  |
| Exercised                           | (63,310) | \$ 20.14                              | \$ 4.43   |



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The following table provides information about unvested options for the three months ended June 30, 2014:

|                                  | <b>Shares</b> | <b>Weighted<br/>Average<br/>Exercise Price</b> | <b>Weighted<br/>Average Grant<br/>Date Fair<br/>Value</b> |
|----------------------------------|---------------|--|---|
| Unvested options, March 31, 2014 | 30,146        | \$ 18.27                                       | \$ 4.42   |
| Granted                          |               | \$   | \$  |
| Vested                           |               | \$   | \$  |
| Forfeited                        |               | \$   | \$  |
| Unvested options, June 30, 2014  | 30,146        | \$ 18.27                                       | \$ 4.42   |

The following table provides information about unvested options for the six months ended June 30, 2014:

|                                     | <b>Shares</b> | <b>Weighted<br/>Average<br/>Exercise Price</b> | <b>Weighted<br/>Average Grant<br/>Date Fair<br/>Value</b> |
|-------------------------------------|---------------|--|---|
| Unvested options, December 31, 2013 | 30,146        | \$ 18.27                                       | \$ 4.42   |
| Granted                             |               | \$   | \$  |
| Vested                              |               | \$   | \$  |
| Forfeited                           |               | \$   | \$  |
| Unvested options, June 30, 2014     | 30,146        | \$ 18.27                                       | \$ 4.42   |

For the three and six months ended June 30, 2014, the Corporation recognized \$25 thousand and \$50 thousand, respectively, of expense related to stock options. As of June 30, 2014, the total not-yet-recognized compensation expense of unvested stock options was \$14 thousand. This expense will be recognized over a weighted average period of 0.1 years.

Proceeds, related tax benefits realized from options exercised and intrinsic value of options exercised during the three and six months ended June 30, 2014 and 2013 are detailed below:

| <i>(dollars in thousands)</i>           | Three Months Ended June 30, Six Months Ended June 30, |        |          |          |
|---|---|--------|----------|----------|
|   | 2014  | 2013   | 2014     | 2013     |
| Proceeds from exercise of stock options | \$ 1,274  | \$ 510 | \$ 1,377 | \$ 1,740 |
| Related tax benefit recognized          | 152   | 28     | 174      | 144      |
| Net proceeds of options exercised       | \$ 1,426  | \$ 538 | \$ 1,551 | \$ 1,884 |
| Intrinsic value of options exercised    | \$ 510  | \$ 113 | \$ 577   | \$ 447   |



The following table provides information about options outstanding and exercisable at June 30, 2014:

| <i>(dollars in thousands, except exercise price)</i> | <b>Outstanding</b> | <b>Exercisable</b> |
|--|--------------------|--------------------|
| Number of shares                                     | 521,886            | 491,740            |
| Weighted average exercise price                      | \$ 20.84           | \$ 21.00           |
| Aggregate intrinsic value                            | \$ 4,319           | \$ 3,992           |
| Weighted average contractual term in years           | 3.0                | 2.8                |

### **C. Restricted Stock Awards and Performance Stock Awards**

The Corporation has granted RSAs, PSAs and PSUs under the 2007 LTIP and 2010 LTIP.

#### **RSAs and RSUs**

The compensation expense for the RSAs and RSUs is measured based on the market price of the stock on the day prior to the grant date and is recognized on a straight line basis over the vesting period.

For the three and six months ended June 30, 2014, the Corporation recognized \$81 thousand and \$162 thousand, respectively of expense related to the Corporation's RSAs and RSUs. As of June 30, 2014, there was \$313 thousand of unrecognized compensation cost related to RSAs and RSUs. This cost will be recognized over a weighted average period of 1.3 years.

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The following table details the unvested RSAs and RSUs for the three and six months ended June 30, 2014:

|                   | Three Months Ended<br>June 30, 2014 |   | Six Months Ended<br>June 30, 2014 |   |
|-------------------|-------------------------------------|---|-----------------------------------|---|
|                   | Number of<br>Shares                 | Weighted<br>Average<br>Grant Date<br>Fair Value | Number of<br>Shares               | Weighted<br>Average<br>Grant Date<br>Fair Value |
| Beginning balance | 41,500                              | \$ 19.93  | 54,156                            | \$ 19.36  |
| Granted           |                                     |   |                                   |   |
| Vested            | (6,135)                             | 20.38   | (18,791)                          | 18.44   |
| Forfeited         |                                     |   |                                   |   |
| Ending balance    | 35,365                              | \$ 19.85  | 35,365                            | \$ 19.85  |

For the three and six months ended June 30, 2014, the Corporation recorded a tax benefit of \$16 thousand and \$66 thousand related to the vesting of RSAs.

**PSAs and PSUs**

The compensation expense for PSAs and PSUs is measured based on the grant date fair value as calculated using the Monte Carlo Simulation method.

For the three and six months ended June 30, 2014, the Corporation recognized \$196 thousand and \$397 thousand of expense related to the PSAs and PSUs. As of June 30, 2014, there was \$1.1 million of unrecognized compensation cost related to PSAs. This cost will be recognized over a weighted average period of 1.8 years.

The following table details the unvested PSAs and PSUs for the three and six months ended June 30, 2014:

|                   | Three Months Ended<br>June 30, 2014 |   | Six Months Ended<br>June 30, 2014 |   |
|-------------------|-------------------------------------|---|-----------------------------------|---|
|                   | Number of<br>Shares                 | Weighted<br>Average<br>Grant Date<br>Fair Value | Number of<br>Shares               | Weighted<br>Average<br>Grant Date<br>Fair Value |
| Beginning balance | 204,980                             | \$ 11.90  | 204,980                           | \$ 11.90  |
| Granted           |                                     |   |                                   |   |
| Vested            |                                     |   |                                   |   |
| Forfeited         | (1,000)                             | 12.09   | (1,000)                           | 12.09   |
| Ending balance    | 203,980                             | \$ 11.90  | 203,980                           | \$ 11.90  |

**Note 9 - Pension and Other Post-Retirement Benefit Plans**

The Corporation has three defined benefit pension plans: the qualified defined-benefit plan (the QDBP ) which covers all employees over age 20 1/2 who meet certain service requirements, and two non-qualified defined-benefit pension plans ( SERP I and SERP II ) which are restricted to certain senior officers of the Corporation.

SERP I provides each participant with the equivalent pension benefit provided by the QDBP on any compensation and bonus deferrals that exceed the IRS limit applicable to the QDBP.

On February 12, 2008, the Corporation amended the QDBP and SERP I to freeze further increases in the defined-benefit amounts to all participants, effective March 31, 2008.

On April 1, 2008, the Corporation added SERP II, a non-qualified defined-benefit plan which was restricted to certain senior officers of the Corporation. Effective January 1, 2013, the Corporation curtailed SERP II, as further increases to the defined-benefit amounts to over 20% of the participants have been frozen. As a result of the curtailment, for the three and six months ended June 30, 2013, the Corporation recorded a gain of \$120 thousand and \$690 thousand, respectively, which represented the reversal of previous amounts that had been expensed in anticipation of future service of the curtailed participants.

The Corporation also has a postretirement benefit plan ( PRBP ) that covers certain retired employees and a group of current employees. The PRBP was closed to new participants in 1994. In 2007, the Corporation amended the PRBP to allow for settlement of obligations to certain current and retired employees. Certain retired participant obligations were settled in 2007 and current employee obligations were settled in 2008.

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The following tables provide details of the components of the net periodic benefits cost (benefit) for the three and six months ended June 30, 2014 and 2013:

| <i>(dollars in thousands)</i>         | Three Months Ended June 30, |         |          |       |       |       |
|---------------------------------------|-----------------------------|---------|----------|-------|-------|-------|
|                                       | SERP I and SERP II          |         | QDBP     |       | PRBP  |       |
|                                       | 2014                        | 2013    | 2014     | 2013  | 2014  | 2013  |
| Service cost                          | \$ 18                       | \$ 18   | \$       | \$    | \$    | \$    |
| Interest cost                         | 45                          | 39      | 410      | 371   | 7     | 7     |
| Expected return on plan assets        |                             |         | (837)    | (745) |       |       |
| Amortization of transition obligation |                             |         |          |       |       |       |
| Amortization of prior service costs   | 4                           | 4       |          |       |       |       |
| Amortization of net loss              | 11                          | 13      | 98       | 431   | 15    | 20    |
| Gain on curtailment                   |                             | (120)   |          |       |       |       |
| Net periodic benefit cost             | \$ 78                       | \$ (46) | \$ (329) | \$ 57 | \$ 22 | \$ 27 |

| <i>(dollars in thousands)</i>         | Six Months Ended June 30, |          |          |         |       |       |
|---------------------------------------|---------------------------|----------|----------|---------|-------|-------|
|                                       | SERP I and SERP II        |          | QDBP     |         | PRBP  |       |
|                                       | 2014                      | 2013     | 2014     | 2013    | 2014  | 2013  |
| Service cost                          | \$ 36                     | \$ 36    | \$       | \$      | \$    | \$    |
| Interest cost                         | 91                        | 79       | 820      | 743     | 14    | 14    |
| Expected return on plan assets        |                           |          | (1,674)  | (1,491) |       |       |
| Amortization of transition obligation |                           |          |          |         |       |       |
| Amortization of prior service costs   | 7                         | 7        |          |         |       |       |
| Amortization of net loss              | 22                        | 26       | 196      | 862     | 30    | 39    |
| Gain on curtailment                   |                           | (690)    |          |         |       |       |
| Net periodic benefit cost             | \$ 156                    | \$ (542) | \$ (658) | \$ 114  | \$ 44 | \$ 53 |

**QDBP:** No contributions to the QDBP were made for the three and six months ended June 30, 2014.

**SERP I and SERP II:** The Corporation contributed \$37 thousand and \$74 thousand during the three and six months ended June 30, 2014, respectively, and is expected to contribute an additional \$74 thousand to the SERP I and SERP II plans for the remaining six months of 2014.

**PRBP:** In 2005, the Corporation capped the maximum annual payment under the PRBP at 120% of the 2005 benefit. This maximum was reached in 2008 and the cap is not expected to be increased above this level.

**Table of Contents****Note 10 - Segment Information**

The Corporation aggregates certain of its operations and has identified two segments as follows: Banking and Wealth Management.

The following tables detail segment information for the three and six months ended June 30, 2014 and 2013:

| <i>(dollars in thousands)</i>                     | <b>Three Months Ended June 30, 2014</b> |                          |                     | <b>Three Months Ended June 30, 2013</b> |                          |                     |
|---|---|--------------------------|---------------------|---|--------------------------|---------------------|
|   | <b>Banking</b>                          | <b>Wealth Management</b> | <b>Consolidated</b> | <b>Banking</b>                          | <b>Wealth Management</b> | <b>Consolidated</b> |
| Net interest income                               | \$ 19,441                               | \$ 1                     | \$ 19,442           | \$ 17,922                               | \$ 1                     | \$ 17,923           |
| Less: loan loss provision                         | (100)                                   |                          | (100)               | 1,000                                   |                          | 1,000               |
| Net interest income after loan loss provision     | 19,541                                  | 1                        | 19,542              | 16,922                                  | 1                        | 16,923              |
| Other income:                                     |   |                          |                     |   |                          |                     |
| Fees for wealth management services               |   | 9,499                    | 9,499               |   | 9,094                    | 9,094               |
| Service charges on deposit accounts               | 656                                     |                          | 656                 | 596                                     |                          | 596                 |
| Loan servicing and other fees                     | 428                                     |                          | 428                 | 448                                     |                          | 448                 |
| Net gain on sale of loans                         | 537                                     |                          | 537                 | 1,492                                   |                          | 1,492               |
| Net gain on sale of available for sale securities | 85                                      |                          | 85                  |   |                          |                     |
| Net loss on sale of other real estate owned       | 220                                     |                          | 220                 | (141)                                   |                          | (141)               |
| BOLI income                                       | 74                                      |                          | 74                  | 85                                      |                          | 85                  |
| Other operating income                            | 1,232                                   | 26                       | 1,258               | 1,322                                   | 47                       | 1,369               |
| Total other income                                | 3,232                                   | 9,525                    | 12,757              | 3,802                                   | 9,141                    | 12,943              |
| Other expenses:                                   |   |                          |                     |   |                          |                     |
| Salaries & wages                                  | 6,539                                   | 3,155                    | 9,694               | 6,040                                   | 3,046                    | 9,086               |
| Employee benefits                                 | 1,057                                   | 752                      | 1,809               | 1,463                                   | 749                      | 2,212               |
| Occupancy & equipment                             | 1,308                                   | 375                      | 1,683               | 1,354                                   | 374                      | 1,728               |
| Amortization of intangible assets                 | 71                                      | 565                      | 636                 | 80                                      | 580                      | 660                 |
| Professional fees                                 | 883                                     | 31                       | 914                 | 614                                     | 50                       | 664                 |
| Other operating expenses                          | 5,053                                   | 837                      | 5,890               | 5,130                                   | 1,044                    | 6,174               |
| Total other expenses                              | 14,911                                  | 5,715                    | 20,626              | 14,681                                  | 5,843                    | 20,524              |
| Segment profit                                    | 7,862                                   | 3,811                    | 11,673              | 6,043                                   | 3,299                    | 9,342               |
| Intersegment (revenues) expenses*                 | (93)                                    | 93                       |                     | (152)                                   | 152                      |                     |

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|  |          |          |           |          |          |          |
|--|----------|----------|-----------|----------|----------|----------|
| Pre-tax segment profit after eliminations      | \$ 7,769 | \$ 3,904 | \$ 11,673 | \$ 5,891 | \$ 3,451 | \$ 9,342 |
| % of segment pre-tax profit after eliminations | 66.6%    | 33.4%    | 100.0%    | 63.1%    | 36.9%    | 100.0%   |
| Segment assets ( <i>dollars in millions</i> )  | \$ 2,091 | \$ 40    | \$ 2,131  | \$ 1,967 | \$ 43    | \$ 2,010 |

\* Inter-segment revenues consist of rental payments, interest on deposits and management fees.

| <i>(dollars in thousands)</i>                     | Six Months Ended June 30, 2014 |                   |              | Six Months Ended June 30, 2013 |                   |              |
|---|--------------------------------|-------------------|--------------|--------------------------------|-------------------|--------------|
|   | Banking                        | Wealth Management | Consolidated | Banking                        | Wealth Management | Consolidated |
| Net interest income                               | \$ 38,164                      | \$ 1              | \$ 38,165    | \$ 35,331                      | \$ 1              | \$ 35,332    |
| Less: loan loss provision                         | 650                            |                   | 650          | 1,804                          |                   | 1,804        |
| Net interest income after loan loss provision     | 37,514                         | 1                 | 37,515       | 33,527                         | 1                 | 33,528       |
| Other income:                                     |                                |                   |              |                                |                   |              |
| Fees for wealth management services               |                                | 18,412            | 18,412       |                                | 17,443            | 17,443       |
| Service charges on deposit accounts               | 1,257                          |                   | 1,257        | 1,180                          |                   | 1,180        |
| Loan servicing and other fees                     | 874                            |                   | 874          | 899                            |                   | 899          |
| Net gain on sale of loans                         | 861                            |                   | 861          | 3,010                          |                   | 3,010        |
| Net gain on sale of available for sale securities | 81                             |                   | 81           | 2                              |                   | 2            |
| Net loss on sale of other real estate owned       | 220                            |                   | 220          | (193)                          |                   | (193)        |
| BOLI income                                       | 155                            |                   | 155          | 198                            |                   | 198          |
| Other operating income                            | 1,966                          | 70                | 2,036        | 2,104                          | 90                | 2,194        |
| Total other income                                | 5,414                          | 18,482            | 23,896       | 7,200                          | 17,533            | 24,733       |
| Other expenses:                                   |                                |                   |              |                                |                   |              |
| Salaries & wages                                  | 12,186                         | 5,948             | 18,134       | 11,911                         | 5,985             | 17,896       |
| Employee benefits                                 | 2,270                          | 1,519             | 3,788        | 3,040                          | 1,497             | 4,537        |
| Occupancy & equipment                             | 2,882                          | 734               | 3,616        | 2,728                          | 750               | 3,478        |
| Amortization of intangible assets                 | 141                            | 1,131             | 1,273        | 160                            | 1,161             | 1,321        |
| Professional fees                                 | 1,450                          | 57                | 1,507        | 1,123                          | 116               | 1,239        |
| Other operating expenses                          | 9,355                          | 1,852             | 11,207       | 10,268                         | 2,020             | 12,288       |
| Total other expenses                              | 28,284                         | 11,241            | 39,525       | 29,230                         | 11,529            | 40,759       |
| Segment profit                                    | 14,644                         | 7,242             | 21,886       | 11,497                         | 6,005             | 17,502       |
|   | (186)                          | 186               |              | (304)                          | 304               |              |

|  |           |          |           |           |          |           |
|--|-----------|----------|-----------|-----------|----------|-----------|
| Intersegment (revenues) expenses*              |           |          |           |           |          |           |
| Pre-tax segment profit after eliminations      | \$ 14,458 | \$ 7,428 | \$ 21,886 | \$ 11,193 | \$ 6,309 | \$ 17,502 |
| % of segment pre-tax profit after eliminations | 66.1%     | 33.9%    | 100.0%    | 64.0%     | 36.0%    | 100.0%    |
| Segment assets ( <i>dollars in millions</i> )  | \$ 2,091  | \$ 40    | \$ 2,131  | \$ 1,967  | \$ 43    | \$ 2,010  |

\* Inter-segment revenues consist of rental payments, interest on deposits and management fees. Other segment information is as follows:

### Wealth Management Segment Information

|   | <i>(dollars in millions)</i> |                   |
|---|------------------------------|-------------------|
|   | June 30, 2014                | December 31, 2013 |
| Assets under management, administration, supervision and brokerage: | \$ 7,569.8                   | \$ 7,268.3        |

**Table of Contents****Note 11 - Mortgage Servicing Rights**

The following tables summarize the Corporation's activity related to mortgage servicing rights (MSRs) for the three and six months ended June 30, 2014 and 2013:

| <i>(dollars in thousands)</i> | <b>Three Months Ended June 30,</b> |             |
|-------------------------------|------------------------------------|-------------|
|                               | <b>2014</b>                        | <b>2013</b> |
| Balance, beginning of period  | \$ 4,734                           | \$ 4,593    |
| Additions                     | 151                                | 324         |
| Amortization                  | (128)                              | (218)       |
| Recovery                      | 3                                  | 91          |
| Impairment                    |                                    |             |
| Balance, end of period        | \$ 4,760                           | \$ 4,790    |
| Fair value                    | \$ 5,552                           | \$ 5,621    |
| Loans serviced for others     | \$ 622,808                         | \$ 623,498  |

| <i>(dollars in thousands)</i> | <b>Six Months Ended June 30,</b> |             |
|-------------------------------|----------------------------------|-------------|
|                               | <b>2014</b>                      | <b>2013</b> |
| Balance, beginning of period  | \$ 4,750                         | \$ 4,491    |
| Additions                     | 241                              | 709         |
| Amortization                  | (242)                            | (430)       |
| Recovery                      | 11                               | 91          |
| Impairment                    |                                  | (71)        |
| Balance, end of period        | \$ 4,760                         | \$ 4,790    |
| Fair value                    | \$ 5,552                         | \$ 5,621    |
| Loans serviced for others     | \$ 622,808                       | \$ 623,498  |

As of June 30, 2014 and December 31, 2013, key economic assumptions and the sensitivity of the current fair value of MSRs to immediate 10 and 20 percent adverse changes in those assumptions are as follows:

| <i>(dollars in thousands)</i>                 | <b>June 30, 2014</b> | <b>December 31, 2013</b> |
|---|----------------------|--------------------------|
| Fair value amount of MSRs                     | \$ 5,552             | \$ 5,733                 |
| Weighted average life (in years)              | 6.4                  | 6.3                      |
| Prepayment speeds (constant prepayment rate)* | 10.4                 | 11.1                     |
| Impact on fair value:                         |                      |                          |



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|                       |    |       |    |        |
|-----------------------|----|-------|----|--------|
| 10% adverse change    | \$ | (182) | \$ | (206)  |
| 20% adverse change    | \$ | (359) | \$ | (402)  |
| Discount rate         |    | 10.5% |    | 10.50% |
| Impact on fair value: |    |       |    |        |
| 10% adverse change    | \$ | (219) | \$ | (231)  |
| 20% adverse change    | \$ | (421) | \$ | (445)  |

\* *Represents the weighted average prepayment rate for the life of the MSR asset.*

These assumptions and sensitivities are hypothetical and should be used with caution. Changes in fair value based on a 10% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumptions to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of the MSRs is calculated without changing any other assumption. In reality, changes in one factor may result in changes in another, which could magnify or counteract the sensitivities.

**Table of Contents****Note 12 - Goodwill and Other Intangibles**

The Corporation's goodwill and intangible assets related to the acquisitions of Lau Associates LLC ( Lau ) in July, 2008, First Keystone Financial, Inc. ( FKF ) in July, 2010, the Private Wealth Management Group of the Hershey Trust Company ( PWMG ) in May, 2011, and Davidson Trust Company ( DTC ) in May, 2012, and the First Bank of Delaware ( FBD ) transaction in November, 2012 are detailed below:

|                               |                 | Balance              |                           | Balance           |                  | Amortization<br>Period |
|-------------------------------|-----------------|----------------------|---------------------------|-------------------|------------------|------------------------|
|                               |                 | December 31,<br>2013 | Additions/<br>Adjustments | Amortization      | June 30,<br>2014 |                        |
| <i>(dollars in thousands)</i> |                 |                      |                           |                   |                  |                        |
| Goodwill                      | Wealth segment  | \$ 20,412            | \$                        | \$                | \$ 20,412        | Indefinite             |
| Goodwill                      | Banking segment | 12,431               |                           |                   | 12,431           | Indefinite             |
| <b>Total</b>                  |                 | <b>\$ 32,843</b>     | <b>\$</b>                 | <b>\$</b>         | <b>\$ 32,843</b> |                        |
| Core deposit intangible       |                 | \$ 1,342             | \$                        | \$ (142)          | \$ 1,200         | 10 Years               |
| Customer relationships        |                 | 13,595               |                           | (618)             | 12,977           | 10 to 20 Years         |
| Non-compete agreements        |                 | 3,218                |                           | (513)             | 2,705            | 5 to 5 ½ Years         |
| Trade name                    |                 | 1,210                |                           |                   | 1,210            | Indefinite             |
| <b>Total</b>                  |                 | <b>\$ 19,365</b>     | <b>\$</b>                 | <b>\$ (1,273)</b> | <b>\$ 18,092</b> |                        |
| <b>Grand total</b>            |                 | <b>\$ 52,208</b>     | <b>\$</b>                 | <b>\$ (1,273)</b> | <b>\$ 50,935</b> |                        |

The Corporation performed its annual review of goodwill and identifiable intangible assets as of December 31, 2013 in accordance with ASC 350, Intangibles Goodwill and Other. For the three and six months ended June 30, 2014, the Corporation determined there were no events that would necessitate impairment testing of goodwill and other intangible assets.

**Note 13 - Accumulated Other Comprehensive Loss**

The following tables detail the components of accumulated other comprehensive (loss) income for the three and six month periods ended June 30, 2014 and 2013:

|                               | Net Change in   |   |   |   |
|-------------------------------|---|---|---|---|
|                               | Net Change in<br>Unrealized Gains<br>on<br>Available-for-<br>Sale<br>Investment<br>Securities | Fair<br>Value of<br>Derivative<br>Used for<br>Cash<br>Flow<br>Hedge | Net Change in<br>Unfunded<br>Pension<br>Liability | Accumulated<br>Other<br>Comprehensive<br>Loss |
| <i>(dollars in thousands)</i> |   |   |   |   |
| Balance, March 31, 2014       | \$ 288  | \$ 516  | \$ (5,405)  | \$ (4,601)                                    |
| Net change                    | 1,248   | (242)   | 47  | 1,053   |

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|                         |    |         |        |             |             |
|-------------------------|----|---------|--------|-------------|-------------|
| Balance, June 30, 2014  | \$ | 1,536   | 274    | (5,358)     | (3,548)     |
| Balance, March 31, 2013 | \$ | 3,147   | \$ 95  | \$ (11,807) | \$ (8,565)  |
| Net change              |    | (3,270) | 482    | 248         | (2,540)     |
| Balance, June 30, 2013  | \$ | (123)   | \$ 577 | \$ (11,559) | \$ (11,105) |

|                               |    | <b>Net Change in<br/>Unrealized Gains<br/>on<br/>Available-for-<br/>Sale<br/>Investment<br/>Securities</b> | <b>Net Change in<br/>Fair<br/>Value of<br/>Derivative<br/>Used for<br/>Cash<br/>Flow<br/>Hedge</b> | <b>Net Change in<br/>Unfunded<br/>Pension<br/>Liability</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Loss</b> |
|-------------------------------|----|--|--|---|---|
| <i>(dollars in thousands)</i> |    |  |  |   |   |
| Balance, December 31, 2013    | \$ | (857)  | \$ 743   | \$ (5,451)  | \$ (5,565)  |
| Net change                    |    | 2,393  | (469)  | 93  | 2,017   |
| Balance, June 30, 2014        | \$ | 1,536  | 274  | (5,358)   | (3,548)   |
| Balance, December 31, 2012    | \$ | 3,164  | \$ (24)  | \$ (13,218)   | \$ (10,078)   |
| Net change                    |    | (3,287)  | 601  | 1,659   | (1,027)   |
| Balance, June 30, 2013        | \$ | (123)  | \$ 577   | \$ (11,559)   | \$ (11,105)   |

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The following tables detail the amounts reclassified from each component of accumulated other comprehensive loss to each component's applicable income statement line, for the three and six month periods ended June 30, 2014 and 2013:

| Description of Accumulated Other Comprehensive Loss Component                 | Amount Reclassified from Accumulated Other Comprehensive Loss |        | Affected Income Statement Category                           |
|---|---|--------|--|
|   | The Three Months Ended June 30, 2014                          | 2013   |  |
| <b>Net unrealized gain on investment securities available for sale:</b>       |   |        |  |
| Realization of gain on sale of investment securities available for sale       | \$ (85)   | \$     | Net gain on sale of available for sale investment securities |
|   | 30  |        | Less: income tax expense                                     |
|   | \$ (55)   | \$     | Net of income tax  |
| <b>Unfunded pension liability:</b>  |   |        |  |
| Amortization of net loss included in net periodic pension costs*              | \$ 124  | \$ 464 | Employee benefits  |
| Amortization of prior service cost included in net periodic pension costs*    | 4   | 4      | Employee benefits  |
| Amortization of transition obligation included in net periodic pension costs* |   |        | Employee benefits  |
| Gain on curtailment of SERP II  |   | (120)  | Net gain on curtailment of nonqualified pension plan         |
|   |   |        | Total expense before income tax benefit                      |
|   | 128   | 348    |  |
|   | 45  | 122    | Less: income tax benefit                                     |
|   | \$ 83   | \$ 226 | Net of income tax  |

| Description of Accumulated Other Comprehensive Loss Component           | Amount Reclassified from Accumulated Other Comprehensive Loss |        | Affected Income Statement Category                           |
|---|---|--------|--|
|   | The Six Months Ended June 30, 2014                            | 2013   |  |
| <b>Net unrealized gain on investment securities available for sale:</b> |   |        |  |
| Realization of gain on sale of investment securities available for sale | \$ (81)   | \$ (2) | Net gain on sale of available for sale investment securities |
|   | 29  | (1)    | Less: income tax expense                                     |

|   |         |  |                                 |
|---|---------|--|---------------------------------|
|   | \$ (52) | \$ (1)   | Net of income tax               |
| <b><i>Unfunded pension liability:</i></b>                                     |         |  |                                 |
| Amortization of net loss included in net periodic pension costs*              | \$ 248  | \$ 927   | Employee benefits               |
| Amortization of prior service cost included in net periodic pension costs*    | 7       | 7  | Employee benefits               |
| Amortization of transition obligation included in net periodic pension costs* |         |  | Employee benefits               |
| Gain on curtailment of SERP II  |         | Net gain on curtailment of nonqualified pension plan |                                 |
|   |         | (690)  |                                 |
|   |         |  | Total expense before income tax |
|   | 255     | 244  | benefit                         |
|   | 89      | 85   | Less: income tax benefit        |
|   | \$ 166  | \$ 159   | Net of income tax               |

\*Accumulated other comprehensive loss components are included in the computation of net periodic pension cost. See Note 10 Pension and Other Post-Retirement Benefit Plans

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**Table of Contents****Note 14 - Shareholders' Equity****Dividend**

On July 24, 2014, the Corporation's Board of Directors declared a regular quarterly dividend of \$0.19 per share payable September 1, 2014 to shareholders of record as of August 5, 2014. During the second quarter of 2014, the Corporation declared and paid a regular quarterly dividend of \$0.18 per share. This payment totaled \$2.5 million, based on outstanding shares at May 13, 2014 of 13,780,630. During the first quarter of 2014, the Corporation declared and paid a regular quarterly dividend of \$0.18 per share. This payment totaled \$2.5 million, based on outstanding shares at February 10, 2014 of 13,649,305.

**S-3 Shelf Registration Statement and Offerings Thereunder**

In April 2012, the Corporation filed a shelf registration statement (the "Shelf Registration Statement") to replace its 2009 Shelf Registration Statement, which was set to expire in June 2012. This new Shelf Registration Statement allows the Corporation to raise additional capital through offers and sales of registered securities consisting of common stock, debt securities, warrants to purchase common stock, stock purchase contracts and units or units consisting of any combination of the foregoing securities. Using the prospectus in the Shelf Registration Statement, together with applicable prospectus supplements, the Corporation may sell, from time to time, in one or more offerings, such securities in a dollar amount up to \$150,000,000, in the aggregate.

The Corporation has in place under its Shelf Registration Statement a Dividend Reinvestment and Stock Purchase Plan (the "Plan"), which was amended and restated on April 27, 2012, primarily to increase the number of shares which can be issued by the Corporation from 850,000 to 1,500,000 shares of registered common stock. The Plan allows for the grant of a request for waiver ("RFW") above the Plan's maximum investment of \$120 thousand per account per year. An RFW is granted based on a variety of factors, including the Corporation's current and projected capital needs, prevailing market prices of the Corporation's common stock and general economic and market conditions.

The Plan is intended to allow both existing shareholders and new investors to easily and conveniently increase their investment in the Corporation without incurring many of the fees and commissions normally associated with brokerage transactions. For the six months ended June 30, 2014, the Corporation issued 1,159 shares and raised \$32 thousand through the Plan.

**Options**

In addition to shares issued through the Plan, the Corporation also issues shares through the exercise of stock options. During the six months ended June 30, 2014, 69,200 shares were issued pursuant to the exercise of stock options, increasing shareholders' equity by \$1.4 million.

**Note 15 - Accounting for Uncertainty in Income Taxes**

The Corporation recognizes the financial statement benefit of a tax position only after determining that the Corporation would be more likely than not to sustain the position following an examination. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50% likelihood of being realized upon settlement with the relevant tax authority.

The Corporation is subject to income taxes in the United States federal jurisdiction and multiple state jurisdictions. The Corporation is no longer subject to U.S. federal income tax examination by taxing authorities for years before

2011.

The Corporation's policy is to record interest and penalties on uncertain tax positions as income tax expense. No interest or penalties were accrued for the three or six month periods ended June 30, 2014 or 2013.

#### **Note 16 - Fair Value Measurement**

The following disclosures are made in conjunction with the application of fair value measurements.

FASB ASC 820 Fair Value Measurement establishes a fair value hierarchy based on the nature of data inputs for fair value determinations, under which the Corporation is required to value each asset using assumptions that market participants would utilize to value that asset. When the Corporation uses its own assumptions, it is required to disclose additional information about the assumptions used and the effect of the measurement on earnings or the net change in assets for the period.

The Corporation's investment securities available for sale, which generally include state and municipal securities, U.S. government agency securities and mortgage-related securities, are reported at fair value. These securities are valued by an independent third party. The third party's evaluations are based on market data. They utilize evaluated pricing models that vary by asset and incorporate available trade, bid and other market information. For securities that do not trade on a daily basis, their pricing applications apply available information such as benchmarking and matrix pricing. The market inputs normally sought in the evaluation of securities include benchmark yields, reported trades, broker/dealer quotes (only obtained from market makers or broker/dealers recognized as market participants), issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data. For certain securities, additional inputs may be used or some market inputs may not be applicable. Inputs are prioritized differently on any given day based on market conditions.

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U.S. Government agency securities are evaluated and priced using multi-dimensional relational models and option-adjusted spreads. State and municipal securities are evaluated on a series of matrices including reported trades and material event notices. Mortgage-related securities are evaluated using matrix correlation to treasury or floating index benchmarks, prepayment speeds, monthly payment information and other benchmarks. Other available for sale investments are evaluated using a broker-quote based application, including quotes from issuers. The Corporation has a sufficient understanding of the third party service s valuation models, assumptions and inputs used in determining the fair value of available for sale investments to enable management to maintain an appropriate system of internal control.

The value of the investment portfolio is determined using three broad levels of inputs:

**Level 1** Quoted prices in active markets for identical securities.

**Level 2** Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

**Level 3** Instruments whose significant value drivers are unobservable.

These levels are not necessarily an indication of the risks or liquidity associated with these investments. The following tables summarize the assets at June 30, 2014 and December 31, 2013 that are recognized on the Corporation s balance sheet using fair value measurement determined based on the differing levels of input.

The following table sets forth the fair value of assets measured on a recurring and non-recurring basis as of June 30, 2014:

| <i>(dollars in millions)</i>                                  | <b>Total</b> | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> |
|---|--------------|----------------|----------------|----------------|
| <b>Assets Measured at Fair Value on a Recurring Basis:</b>    |              |                |                |                |
| Investment securities (available for sale and trading):       |              |                |                |                |
| U.S. Treasury securities                                      | \$ 0.1       | \$ 0.1         | \$             | \$             |
| Obligations of the U.S. government agency securities          | 63.3         |                | 63.3           |                |
| Obligations of state & political subdivisions                 | 36.0         |                | 36.0           |                |
| Mortgage-backed securities                                    | 111.0        |                | 111.0          |                |
| Collateralized mortgage obligations                           | 39.8         |                | 39.8           |                |
| Mutual funds  | 17.9         | 17.9           |                |                |
| Other debt securities   | 1.9          |                | 1.9            |                |
| Total assets measured on a recurring basis at fair value      | \$ 270.0     | \$ 18.0        | \$ 252.0       | \$             |
| <b>Assets Measured at Fair Value on a Non-Recurring Basis</b> |              |                |                |                |
| Mortgage servicing rights                                     | \$ 5.6       | \$             | \$             | \$ 5.6         |
| Impaired loans and leases                                     | 14.0         |                |                | 14.0           |
| Other real estate owned ( OREO )                              | 0.9          |                |                | 0.9            |
| Total assets measured on a non-recurring basis at fair value  | \$ 20.5      | \$             | \$             | \$ 20.5        |



The following table sets forth the fair value of assets measured on a recurring and non-recurring basis as of December 31, 2013:

| <i>(dollars in millions)</i>  | <b>Total</b>    | <b>Level 1</b> | <b>Level 2</b>  | <b>Level 3</b> |
|---|-----------------|----------------|-----------------|----------------|
| <b>Assets Measured at Fair Value on a Recurring Basis:</b>          |                 |                |                 |                |
| Investment securities (available for sale and trading):             |                 |                |                 |                |
| U.S. Treasury securities  | \$ 0.1          | \$ 0.1         | \$              | \$             |
| Obligations of the U.S. government agency securities                | 69.5            |                | 69.5            |                |
| Obligations of state & political subdivisions                       | 37.0            |                | 37.0            |                |
| Mortgage-backed securities  | 119.4           |                | 119.4           |                |
| Collateralized mortgage obligations                                 | 44.2            |                | 44.2            |                |
| Mutual funds  | 17.1            | 17.1           |                 |                |
| Other debt securities   | 1.9             |                | 1.9             |                |
| <b>Total assets measured on a recurring basis at fair value</b>     | <b>\$ 289.2</b> | <b>\$ 17.2</b> | <b>\$ 272.0</b> | <b>\$</b>      |
| <b>Assets Measured at Fair Value on a Non-Recurring Basis</b>       |                 |                |                 |                |
| Mortgage servicing rights   | \$ 4.9          | \$             | \$              | \$ 4.9         |
| Impaired loans and leases   | 16.1            |                |                 | 16.1           |
| OREO  | 0.9             |                |                 | 0.9            |
| <b>Total assets measured on a non-recurring basis at fair value</b> | <b>\$ 21.9</b>  | <b>\$</b>      | <b>\$</b>       | <b>\$ 21.9</b> |

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During the three and six months ended June 30, 2014 a net increase of \$78 thousand and a net decrease of \$68 thousand, respectively, were recorded in the Allowance as a result of adjusting the carrying value and estimated fair value of the impaired loans in the above tables. As it relates to the fair values of assets measured on a recurring basis, there have been no transfers between levels during the six months ended June 30, 2014.

## **Impaired Loans**

The Corporation evaluates and values impaired loans at the time the loan is identified as impaired, and the fair values of such loans are estimated using Level 3 inputs in the fair value hierarchy. Each loan's collateral has a unique appraisal and management's discount of the value is based on the factors unique to each impaired loan. The significant unobservable input in determining the fair value is management's subjective discount on appraisals of the collateral securing the loan, which range from 10% - 50%. Collateral may consist of real estate and/or business assets including equipment, inventory and/or accounts receivable and the value of these assets is determined based on the appraisals by qualified licensed appraisers hired by the Corporation. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, estimated costs to sell, and/or management's expertise and knowledge of the client and the client's business.

The Corporation has an appraisal policy in which an appraisal is obtained for a commercial loan at the point at which the loan either becomes nonperforming or is downgraded to a substandard or worse classification. For consumer loans, the Corporation obtains updated appraisals when a loan becomes 90 days past due or when it receives other information that may indicate possible impairment. Based on the appraisals obtained by the Corporation, an appropriate Allowance is allocated to the particular loan.

## **Other Real Estate Owned**

Other real estate owned consists of properties acquired as a result of foreclosures and deeds in-lieu-of foreclosure. Properties are classified as OREO and are reported at the lower of cost or fair value less cost to sell, and are classified as Level 3 in the fair value hierarchy.

## **Mortgage Servicing Rights**

MSRs do not trade in an active, open market with readily observable prices. Accordingly, the Corporation obtains the fair value of the MSRs using a third-party pricing provider. The provider determines the fair value by discounting projected net servicing cash flows of the remaining servicing portfolio. The valuation model used by the provider considers market loan prepayment predictions and other economic factors which the Corporation considers to be significant unobservable inputs. The fair value of MSRs is mostly affected by changes in mortgage interest rates since rate changes cause the loan prepayment acceleration factors to increase or decrease. All assumptions are market driven. The Corporation has a sufficient understanding of the third party service's valuation models, assumptions and inputs used in determining the fair value of MSRs to enable management to maintain an appropriate system of internal control. Mortgage servicing rights are classified within Level 3 of the fair value hierarchy as the valuation is model driven and primarily based on unobservable inputs.

## **Note 17 - Fair Value of Financial Instruments**

FASB ASC 825, "Disclosures about Fair Value of Financial Instruments" requires disclosure of the fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate such value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other market value techniques. Those techniques are significantly affected by the assumptions used,

including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. The aggregate fair value amounts presented below do not represent the underlying value of the Corporation.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

#### **Cash and Cash Equivalents**

The carrying amounts reported in the balance sheet for cash and cash equivalents approximate their fair values.

#### **Investment Securities**

Estimated fair values for investment securities are generally valued by an independent third party based on market data, utilizing pricing models that vary by asset and incorporate available trade, bid and other market information. Management reviews, annually, the process utilized by its independent third-party valuation experts. On a quarterly basis, Management tests the validity of the prices provided by the third party by selecting a representative sample of the portfolio and obtaining actual trade results, or if actual trade results are not available, competitive broker pricing. See Note 3 of the Notes to Consolidated Financial Statements for more information.

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### **Loans Held for Sale**

The fair value of loans held for sale is based on pricing obtained from secondary markets.

### **Net Portfolio Loans and Leases**

For variable-rate loans that re-price frequently and which have no significant change in credit risk, estimated fair values are based on carrying values. Fair values of certain mortgage loans and consumer loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality and is indicative of an entry price. The estimated fair value of nonperforming loans is based on discounted estimated cash flows as determined by the internal loan review of the Bank or the appraised market value of the underlying collateral, as determined by independent third party appraisers. This technique does not reflect an exit price.

### **Impaired Loans**

The Corporation evaluates and values impaired loans at the time the loan is identified as impaired, and the fair values of such loans are estimated using Level 3 inputs in the fair value hierarchy. Each loan's collateral has a unique appraisal and management's discount of the value is based on the factors unique to each impaired loan. The significant unobservable input in determining the fair value is management's subjective discount on appraisals of the collateral securing the loan, which range from 10% - 50%. Collateral may consist of real estate and/or business assets including equipment, inventory and/or accounts receivable and the value of these assets is determined based on the appraisals by qualified licensed appraisers hired by the Corporation. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, estimated costs to sell, and/or management's expertise and knowledge of the client and the client's business.

### **Mortgage Servicing Rights**

The fair value of the MSR's for these periods was determined using a proprietary third-party valuation model that calculates the present value of estimated future servicing income. The model incorporates assumptions that market participants use in estimating future net servicing income, including estimates of prepayment speeds and discount rates. Due to the proprietary nature of the valuation model used, the Corporation classifies the value of MSR's as using Level 3 inputs.

### **Other Assets**

The carrying amount of accrued interest receivable, income taxes receivable and other investments approximates fair value.

### **Deposits**

The estimated fair values disclosed for noninterest-bearing demand deposits, savings, NOW accounts, and market rate accounts are, by definition, equal to the amounts payable on demand at the reporting date (i.e., their carrying amounts). Fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of expected monthly maturities on the certificate of deposit. FASB Codification 825 defines the fair value of demand deposits as the amount payable on demand as of the reporting date and prohibits adjusting estimated fair value from any value derived from retaining those deposits for an expected future period of time.

**Short-term borrowings**

The carrying amount of short-term borrowings, which include overnight repurchase agreements, fed funds and FHLB advances with original maturity of one year or less, approximates their fair value.

**Long-term FHLB Advances and Other Borrowings**

The fair value of long-term FHLB advances (with original maturities of greater than one year) and other borrowings, which include a \$5.4 million term loan, is established using a discounted cash flow calculation that applies interest rates currently being offered on mid-term and long term borrowings.

**Other Liabilities**

The carrying amounts of accrued interest payable and other accrued payables approximate fair value.

**Off-Balance Sheet Instruments**

Estimated fair values of the Corporation's commitments to extend credit, standby letters of credit and financial guarantees are not included in the table below as their carrying values generally approximate their fair values. These instruments generate fees that approximate those currently charged to originate similar commitments.

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As of the dates indicated, the carrying amount and estimated fair value of the Corporation's financial instruments are as follows:

| <i>(dollars in thousands)</i>                | Fair Value Hierarchy Level* | As of June 30, 2014 |                      | As of December 31 2013 |                      |
|--|-----------------------------|---------------------|----------------------|------------------------|----------------------|
|  |                             | Carrying Amount     | Estimated Fair Value | Carrying Amount        | Estimated Fair Value |
| <b>Financial assets:</b>                     |                             |                     |                      |                        |                      |
| Cash and cash equivalents                    | Level 1                     | \$ 102,964          | \$ 102,964           | \$ 81,071              | \$ 81,071            |
| Investment securities, available for sale    | See Note 16                 | 266,402             | 266,402              | 285,808                | 285,808              |
| Investment securities, trading               | Level 2                     | 3,597               | 3,597                | 3,437                  | 3,437                |
| Loans held for sale                          | Level 2                     | 1,631               | 1,631                | 1,350                  | 1,350                |
| Net portfolio loans and leases               | Level 3                     | 1,600,072           | 1,616,762            | 1,531,670              | 1,534,631            |
| Mortgage servicing rights                    | Level 3                     | 4,760               | 5,552                | 4,750                  | 5,733                |
| Other assets                                 | Level 3                     | 22,808              | 22,808               | 21,819                 | 21,819               |
| <b>Total financial assets</b>                |                             | <b>\$ 2,002,234</b> | <b>\$ 2,019,716</b>  | <b>\$ 1,929,905</b>    | <b>\$ 1,933,849</b>  |
| <b>Financial liabilities:</b>                |                             |                     |                      |                        |                      |
| Deposits                                     | Level 2                     | \$ 1,619,932        | \$ 1,619,636         | \$ 1,591,347           | \$ 1,591,215         |
| Short-term borrowings                        | Level 2                     | 13,320              | 13,320               | 10,891                 | 10,891               |
| Long-term FHLB advances and other borrowings | Level 2                     | 233,132             | 233,363              | 205,644                | 205,149              |
| Other liabilities                            | Level 2                     | 21,470              | 21,470               | 23,885                 | 23,885               |
| <b>Total financial liabilities</b>           |                             | <b>\$ 1,887,854</b> | <b>\$ 1,887,789</b>  | <b>\$ 1,831,767</b>    | <b>\$ 1,831,140</b>  |

\* See Note 16 for a description of fair value hierarchy levels.

**Note 18 - New Accounting Pronouncements****FASB ASU 2014-01, Investments - Equity Method and Joint Ventures (Topic 323), Accounting for Investments in Qualified Affordable Housing Projects.**

Issued in January 2014, ASU 2014-01 provides guidance on accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit. The amendments in this update permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). For those investments in qualified affordable housing projects not accounted for using the proportional amortization method, the investment should be accounted for as an equity method investment or a cost method investment in accordance with Subtopic 970-323. The amendments in this update should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the

date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this update are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. The Corporation is evaluating the impact of the adoption of this guidance. However, it is not expected to have a significant impact on the presentation of the Corporation's consolidated financial statements.

**FASB ASU 2014-04, Receivables Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force).**

Issued in January 2014, ASU 2014-04 clarifies when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loans, such that all or a portion of the loan should be derecognized and the real estate property recognized. ASU 2014-04 states that a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure, or the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. The amendments of ASU 2014-04 also require interim and annual disclosure of both the amount of foreclosed residential real estate property held by the creditor and the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure. The amendments of ASU 2014-04 are effective for interim and annual periods beginning after December 15, 2014, and may be applied using either a modified retrospective transition method or a prospective transition method as described in ASU 2014-04. The adoption of ASU 2014-04 will be a change in presentation only, for the newly required disclosures, and is not expected to have a significant impact to the Corporation's consolidated financial statements.

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**Table of Contents****FASB ASU 2014-06, Technical Corrections and Improvements Related to Glossary Terms.**

Issued in March 2014, ASU 2014-06 clarifies the Master Glossary of the Codification, consolidate multiple instances of the same term into a single definition, or make minor improvements to the Master Glossary that are not expected to result in substantive changes to the application of existing guidance or create a significant administrative cost to most entities. Additionally, the amendments will make the Master Glossary easier to understand, as well as reduce the number of terms appearing in the Master Glossary. The amendments in this update do not have transition guidance and will be effective upon issuance for both public entities and nonpublic entities. The amendments in this update are not expected to result in substantive changes to the application of existing guidance. Additionally, the amendments are not expected to create any new differences between U.S. GAAP and IFRS. The Corporation adopted the provisions of this guidance during the three months ended March 31, 2014 and noted no impact to the consolidated financial statements related to this guidance.

**FASB ASU 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360).**

Issued in April 2014, ASU 2014-08 changes the requirements for reporting discontinued operations in Subtopic 205-20. A discontinued operation may include a component of an entity or a group of components of an entity, or a business or nonprofit activity. The amendments in this update improve the definition of discontinued operations by limiting discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have (or will have) a major effect on an entity's operations and financial results. The amendments in this update also require expanded disclosures for discontinued operations. A public business entity and a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market should apply the amendments in this update prospectively to both of the following: (1) All disposals (or classifications as held for sale) of components of an entity that occur within annual periods beginning on or after December 15, 2014, and interim periods within those years; (2) All businesses or nonprofit activities that, on acquisition, are classified as held for sale that occur within annual periods beginning on or after December 15, 2014, and interim periods within those years. An entity should not apply the amendments in this update to a component of an entity, or a business or nonprofit activity that is classified as held for sale before the effective date even if the component of an entity, or business or nonprofit activity, is disposed of after the effective date. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance. The Corporation does not anticipate a significant impact on its consolidated financial statements related to this guidance.

**FASB ASU 2014-09, Revenue from Contracts with Customers**

Issued on May 28, 2014, ASU No. 2014-09 requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for the Corporation on January 1, 2017. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Corporation is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures. The Corporation has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

**FASB ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period**



Issued on June 19, 2014, ASU 2014-12 requires a reporting entity to treat a performance target that affects vesting and that could be achieved after the requisite service period as a performance condition. A reporting entity should apply FASB ASC Topic 718, Compensation - Stock Compensation, to awards with performance conditions that affect vesting. A performance target that affects vesting and could be achieved after completion of the service period should be treated as a performance condition under FASB ASC 718 and, as a result, should not be included in the estimation of the grant-date fair value of the award. An entity should recognize compensation cost for the award when it becomes probable that the performance target will be achieved. In the event that an entity determines that it is probable that a performance target will be achieved before the end of the service period, the compensation cost of the award should be recognized prospectively over the remaining service period. For all entities, ASU 2014-12 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. ASU 2014-12 may be adopted either prospectively for share-based payment awards granted or modified on or after the effective date, or retrospectively, using a modified retrospective approach. The modified retrospective approach would apply to share-based payment awards outstanding as of the beginning of the earliest annual period presented in the financial statements on adoption, and to all new or modified awards thereafter. The Corporation is evaluating the impact of the adoption of this guidance. However, it is not expected to have a significant impact on its results of operations.

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### **ITEM 2 Management's Discussion and Analysis of Results of Operation and Financial Condition**

The following is the Corporation's discussion and analysis of the significant changes in the financial condition, results of operations, capital resources and liquidity presented in the accompanying consolidated financial statements. Current performance does not guarantee, and may not be indicative of, similar performance in the future.

#### **Brief History of the Corporation**

The Bryn Mawr Trust Company (the Bank) received its Pennsylvania banking charter in 1889 and is a member of the Federal Reserve System. In 1986, Bryn Mawr Bank Corporation (the Corporation) was formed and on January 2, 1987, the Bank became a wholly-owned subsidiary of the Corporation. The Bank and Corporation are headquartered in Bryn Mawr, Pennsylvania, a western suburb of Philadelphia. The Corporation and its subsidiaries provide community banking, business banking, residential mortgage lending, consumer and commercial lending and insurance services to customers through its 19 full-service branches and seven limited-hour retirement community offices located throughout the Montgomery, Delaware and Chester counties of Pennsylvania and New Castle county in Delaware. The Corporation and its subsidiaries also provide wealth management services through its network of Wealth Management offices located in Bryn Mawr, Devon and Hershey, Pennsylvania as well as Greenville, Delaware. The Corporation's stock trades on the NASDAQ Stock Market (NASDAQ) under the symbol BMTC. The goal of the Corporation is to become the preeminent community bank and wealth management organization in the Philadelphia area.

The Corporation operates in a highly competitive market area that includes local, national and regional banks as competitors along with savings banks, credit unions, insurance companies, trust companies, registered investment advisors and mutual fund families. The Corporation and its subsidiaries are regulated by many agencies including the Securities and Exchange Commission (SEC), NASDAQ, Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board and the Pennsylvania Department of Banking and Securities.

#### **Critical Accounting Policies, Judgments and Estimates**

The accounting and reporting policies of the Corporation and its subsidiaries conform with U.S. generally accepted accounting principles (GAAP). All inter-company transactions are eliminated in consolidation and certain reclassifications are made when necessary to conform the previous year's financial statements to the current year's presentation. In preparing the consolidated financial statements, the Corporation is required to make estimates and assumptions that affect the reported amount of assets and liabilities as of the dates of the balance sheets and revenues and expenditures for the periods presented. However, there are uncertainties inherent in making these estimates and actual results could differ from these estimates. The Corporation has identified certain areas that require estimates and assumptions, which include the allowance for loan and lease losses (the Allowance), the valuation of goodwill and intangible assets, the fair value of investment securities, valuation of mortgage servicing rights, deferred tax assets and liabilities, benefit plans and stock-based compensation.

These critical accounting policies, along with other significant accounting policies, are presented in Footnote 1 Summary of Significant Accounting Policies, in the Notes to Consolidated Financial Statements in the Corporation's 2013 Annual Report.

#### **Executive Overview**

The following items highlight the Corporation's results of operations for the three and six months ended June 30, 2014, as compared to the same periods in 2013, and the changes in its financial condition as of June 30, 2014 as compared to

December 31, 2013. More detailed information related to these highlights can be found in the sections that follow.

### Three Month Results

Net income for the three months ended June 30, 2014 was \$7.6 million, an increase of \$1.4 million as compared to net income of \$6.3 million for the same period in 2013. Diluted earnings per share of \$0.55 for the three months ended June 30, 2014 was a \$0.09 increase from the same period in 2013.

Return on average equity ( ROE ) and return on average assets ( ROA ) for the three months ended June 30, 2014 were 12.80% and 1.45%, respectively, as compared to ROE and ROA of 11.90% and 1.28%, respectively, for the same period in 2013.

Tax-equivalent net interest income increased \$1.5 million, or 8.5%, to \$19.6 million for the three months ended June 30, 2014, as compared to \$18.0 million for the same period in 2013.

The Corporation recorded a negative provision for loan and lease losses (the Provision ), or a release from the allowance for loan and lease losses (the Allowance ) of \$100 thousand for the three months ended June 30, 2014, a decrease of \$1.1 million from the \$1.0 million recorded for the same period in 2013.

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Non-interest income of \$12.8 million for the three months ended June 30, 2014 decreased \$186 thousand, or 1.4%, as compared to \$12.9 million for the same period in 2013.

Included in non-interest income, fees for Wealth Management services of \$9.5 million for the three months ended June 30, 2014 increased \$405 thousand, or 4.5%, as compared to \$9.1 million for the same period in 2013.

Non-interest expense of \$20.6 million for the three months ended June 30, 2014 decreased \$102 thousand, or 0.5%, as compared to \$20.5 million for the same period in 2013.

## **Six Month Results**

Net income for the six months ended June 30, 2014 was \$14.3 million, an increase of \$2.7 million as compared to net income of \$11.6 million for the same period in 2013. Diluted earnings per share of \$1.03 for the six months ended June 30, 2014 was an \$0.18 increase from the same period in 2013.

ROE and ROA for the six months ended June 30, 2014 were 12.26% and 1.39%, respectively, as compared to ROE and ROA of 11.25% and 1.18%, respectively, for the same period in 2013.

Tax-equivalent net interest income increased \$2.9 million, or 8.0%, to \$38.4 million for the six months ended June 30, 2014, as compared to \$35.5 million for the same period in 2013.

The provision for loan and lease losses of \$650 thousand for the six months ended June 30, 2014 was a decrease of \$1.2 million, or 64.0%, as compared to \$1.8 million for the same period in 2013.

Non-interest income of \$23.9 million for the six months ended June 30, 2014 decreased \$837 thousand, or 3.4%, as compared to \$24.7 million for the same period in 2013.

Included in non-interest income, fees for Wealth Management services of \$18.4 million for the six months ended June 30, 2014 increased \$969 thousand, or 5.6%, as compared to \$17.4 million for the same period in 2013.

Non-interest expense of \$39.5 million for the six months ended June 30, 2014 decreased \$1.2 million, or 3.0%, as compared to \$40.8 million for the same period in 2013.

## **Changes in Financial Condition**

Total assets of \$2.13 billion as of June 30, 2014 increased \$69.6 million from December 31, 2013.

Shareholders' equity of \$243.4 million as of June 30, 2014 increased \$13.5 million from \$229.9 million as of December 31, 2013.

Total portfolio loans and leases as of June 30, 2014 were \$1.62 billion, an increase of \$68.4 million from the December 31, 2013 balance.

Total non-performing loans and leases of \$8.4 million represented 0.52% of portfolio loans and leases as of June 30, 2014 as compared to \$10.5 million, or 0.68% of portfolio loans and leases as of December 31, 2013.

The \$15.5 million Allowance, as of June 30, 2014, represented 0.96% of portfolio loans and leases, as compared to \$15.5 million, or 1.00% of portfolio loans as of December 31, 2013.

Total deposits of \$1.62 billion as of June 30, 2014 increased \$28.6 million, or 1.8%, from \$1.59 billion as of December 31, 2013.

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Wealth Management assets under management, administration, supervision and brokerage as of June 30, 2014 were \$7.57 billion, an increase of \$301.6 million from December 31, 2013.

**Key Performance Ratios**

Key financial performance ratios for the three and six months ended June 30, 2014 and 2013 are shown in the table below:

|  | Three Months Ended<br>June 30, |         | Six Months Ended<br>June 30, |         |
|--|--------------------------------|---------|------------------------------|---------|
|  | 2014                           | 2013    | 2014                         | 2013    |
| Annualized return on average equity                              | 12.80%                         | 11.90%  | 12.26%                       | 11.25%  |
| Annualized return on average assets                              | 1.45%                          | 1.28%   | 1.39%                        | 1.18%   |
| Efficiency ratio <sup>1</sup>                                    | 64.06%                         | 66.49%  | 63.69%                       | 67.86%  |
| Tax-equivalent net interest margin                               | 4.03%                          | 3.98%   | 4.02%                        | 3.91%   |
| Basic earnings per share   | \$ 0.56                        | \$ 0.47 | \$ 1.06                      | \$ 0.87 |
| Diluted earnings per share                                       | \$ 0.55                        | \$ 0.46 | \$ 1.03                      | \$ 0.86 |
| Dividend per share   | \$ 0.18                        | \$ 0.17 | \$ 0.36                      | \$ 0.34 |
| Dividend declared per share to net income per basic common share | 32.1%                          | 36.2%   | 34.0%                        | 39.1%   |

<sup>1</sup> The efficiency ratio is calculated by dividing non-interest expense by the sum of net interest income and non-interest income.

The following table presents certain key period-end balances and ratios as of June 30, 2014 and December 31, 2013:

|   | June 30,<br>2014 | December 31,<br>2013 |
|---|------------------|----------------------|
| <i>(dollars in millions, except per share amounts)</i>                    |                  |                      |
| Book value per share  | \$ 17.74         | \$ 16.84             |
| Tangible book value per share   | \$ 14.03         | \$ 13.02             |
| Allowance as a percentage of loans and leases                             | 0.96%            | 1.00%                |
| Tier I capital to risk weighted assets                                    | 11.85%           | 11.57%               |
| Tangible common equity ratio  | 9.32%            | 8.92%                |
| Loan to deposit ratio   | 99.8%            | 97.3%                |
| Wealth assets under management, administration, supervision and brokerage | \$ 7,569.8       | \$ 7,268.3           |
| Portfolio loans and leases  | \$ 1,615.5       | \$ 1,547.2           |
| Total assets  | \$ 2,131.2       | \$ 2,061.7           |
| Shareholders equity   | \$ 243.4         | \$ 229.9             |

The following sections discuss, in detail, the Corporation's results of operations for the three and six months ended June 30, 2014, as compared to the same period in 2013, and the changes in its financial condition as of June 30, 2014 as compared to December 31, 2013.

**Components of Net Income**

Net income is comprised of five major elements:

**Net Interest Income**, or the difference between the interest income earned on loans, leases and investments and the interest expense paid on deposits and borrowed funds;

**Provision For Loan and Lease Losses**, or the amount added to the Allowance to provide for estimated inherent losses on portfolio loans and leases;

**Non-Interest Income** which is made up primarily of Wealth Management revenue, gains and losses from the sale of residential mortgage loans, gains and losses from the sale of investment securities available for sale and other fees from loan and deposit services;

**Non-Interest Expense**, which consists primarily of salaries and employee benefits, occupancy, intangible asset amortization, professional fees and other operating expenses; and

**Income Taxes**, which include state and federal jurisdictions.

**Table of Contents****TAX-EQUIVALENT NET INTEREST INCOME**

Net interest income is the primary source of the Corporation's revenue. The below tables present a summary, for the three and six months ended June 30, 2014 and 2013, of the Corporation's average balances and tax-equivalent yields earned on its interest-earning assets and the tax-equivalent rate paid on its interest-bearing liabilities. The tax-equivalent net interest margin is the tax-equivalent net interest income as a percentage of average interest-earning assets. The tax-equivalent net interest spread is the difference between the weighted average tax-equivalent yield on interest-earning assets and the weighted average cost of interest-bearing liabilities. The effect of noninterest-bearing liabilities represents the effect on the net interest margin of net funding provided by noninterest-earning assets, noninterest-bearing liabilities and shareholders' equity.

Tax-equivalent net interest income of \$19.6 million for the three months ended June 30, 2014 increased \$1.5 million, as compared to the same period in 2013. The increase in net interest income between the periods was primarily driven by volume increases, with average loan balances increasing by \$172.3 million, which was partially offset by a \$53.9 million decrease in average available for sale investment securities. The net increase in average interest-earning assets was partially offset by a \$82.3 million increase in average interest-bearing liabilities between periods.

For the six months ended June 30, 2014, tax-equivalent net interest income of \$38.4 million was a \$2.9 million increase from the same period in 2013. Average interest-earning assets for the six months ended June 30, 2014 increased \$93.7 million, while interest-bearing liabilities increased by \$44.5 million from the same period in 2013. The tax-equivalent yield earned on assets increased by 11 basis points and the tax-equivalent rate paid on interest-bearing liabilities increased by 1 basis point.

**Analyses of Interest Rates and Interest Differential**

The table below presents the major asset and liability categories on an average daily balance basis for the periods presented, along with interest income, interest expense and key rates and yields.

|  | For the Three Months Ended June 30, |                                |                                     |                    |                                |                                     |
|--|-------------------------------------|--------------------------------|-------------------------------------|--------------------|--------------------------------|-------------------------------------|
|  | 2014                                |                                |                                     | 2013               |                                |                                     |
|  | Average<br>Balance                  | Interest<br>Income/<br>Expense | Average<br>Rates<br>Earned/<br>Paid | Average<br>Balance | Interest<br>Income/<br>Expense | Average<br>Rates<br>Earned/<br>Paid |
| <i>(dollars in thousands)</i>                  |                                     |                                |                                     |                    |                                |                                     |
| Assets:  |                                     |                                |                                     |                    |                                |                                     |
| Interest-bearing deposits with banks           | \$ 70,775                           | \$ 44                          | 0.25%                               | \$ 59,981          | \$ 41                          | 0.27%                               |
| Investment securities available for sale:      |                                     |                                |                                     |                    |                                |                                     |
| Taxable  | 235,853                             | 903                            | 1.54%                               | 287,287            | 846                            | 1.18%                               |
| Non-taxable <sup>(3)</sup>                     | 35,977                              | 151                            | 1.68%                               | 38,442             | 146                            | 1.52%                               |
| Total investment securities available for sale | 271,830                             | 1,054                          | 1.56%                               | 325,729            | 922                            | 1.22%                               |
| Investment securities trading                  | 3,518                               | 17                             | 1.94%                               | 2,168              | 13                             | 2.41%                               |
| Loans and leases <sup>(1)(2)(3)</sup>          | 1,600,384                           | 19,936                         | 5.00%                               | 1,428,069          | 18,277                         | 5.13%                               |
| Total interest-earning assets                  | 1,946,507                           | 21,051                         | 4.34%                               | 1,815,947          | 19,323                         | 4.27%                               |



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|  |                     |                  |              |                     |                  |              |
|--|---------------------|------------------|--------------|---------------------|------------------|--------------|
| Cash and due from banks  | 12,067              |                  |              | 12,876              |                  |              |
| Allowance for loan and lease losses  | (16,073)            |                  |              | (14,625)            |                  |              |
| Other assets   | 153,990             |                  |              | 151,933             |                  |              |
| <b>Total assets</b>  | <b>\$ 2,096,491</b> |                  |              | <b>\$ 1,966,131</b> |                  |              |
| <b>Liabilities:</b>  |                     |                  |              |                     |                  |              |
| Savings, NOW, and market rate accounts   | \$ 963,746          | 420              | 0.17%        | \$ 969,654          | 445              | 0.18%        |
| Wholesale deposits   | 91,761              | 147              | 0.64%        | 42,734              | 44               | 0.41%        |
| Time deposits  | 127,167             | 146              | 0.46%        | 164,247             | 205              | 0.50%        |
| <b>Total interest-bearing deposits</b>   | <b>1,182,674</b>    | <b>713</b>       | <b>0.24%</b> | <b>1,176,635</b>    | <b>694</b>       | <b>0.24%</b> |
| Short-term borrowings  | 17,220              | 5                | 0.12%        | 13,358              | 4                | 0.12%        |
| Long-term FHLB advances and other borrowings   | 222,851             | 781              | 1.41%        | 150,468             | 596              | 1.59%        |
| <b>Total borrowings</b>  | <b>240,071</b>      | <b>786</b>       | <b>1.31%</b> | <b>163,826</b>      | <b>600</b>       | <b>1.47%</b> |
| <b>Total interest-bearing liabilities</b>  | <b>1,422,745</b>    | <b>1,499</b>     | <b>0.42%</b> | <b>1,340,461</b>    | <b>1,294</b>     | <b>0.39%</b> |
| Non-interest-bearing deposits  | 416,104             |                  |              | 391,387             |                  |              |
| Other liabilities  | 19,368              |                  |              | 23,617              |                  |              |
| <b>Total non-interest-bearing liabilities</b>  | <b>435,472</b>      |                  |              | <b>415,004</b>      |                  |              |
| <b>Total liabilities</b>   | <b>1,858,217</b>    |                  |              | <b>1,755,465</b>    |                  |              |
| Shareholders' equity   | 238,274             |                  |              | 210,666             |                  |              |
| <b>Total liabilities and shareholders' equity</b>                                    | <b>\$ 2,096,491</b> |                  |              | <b>\$ 1,966,131</b> |                  |              |
| <b>Net interest spread</b>   |                     |                  | <b>3.92%</b> |                     |                  | <b>3.88%</b> |
| <b>Effect of non-interest-bearing liabilities</b>                                    |                     |                  | <b>0.11%</b> |                     |                  | <b>0.10%</b> |
| <b>Tax equivalent net interest income and margin on earning assets<sup>(3)</sup></b> |                     | <b>\$ 19,552</b> | <b>4.03%</b> |                     | <b>\$ 18,029</b> | <b>3.98%</b> |
| <b>Tax-equivalent adjustment<sup>(3)</sup></b>                                       |                     | <b>\$ 110</b>    | <b>0.02%</b> |                     | <b>\$ 106</b>    | <b>0.02%</b> |

(1) Nonaccrual loans have been included in average loan balances, but interest on nonaccrual loans has been excluded for purposes of determining interest income.

(2) Loans include portfolio loans and leases and loans held for sale.

(3) Tax rate used for tax-equivalent calculations is 35%.

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|  | For the Six Months Ended June 30, |                    |                          |              |                    |                          |
|--|-----------------------------------|--------------------|--------------------------|--------------|--------------------|--------------------------|
|  | 2014                              |                    |                          | 2013         |                    |                          |
|  | Average                           | Interest           | Average                  | Average      | Interest           | Average                  |
| (dollars in thousands)                         | Balance                           | Income/<br>Expense | Rates<br>Earned/<br>Paid | Balance      | Income/<br>Expense | Rates<br>Earned/<br>Paid |
| <b>Assets:</b>                                 |                                   |                    |                          |              |                    |                          |
| Interest-bearing deposits with banks           | \$ 69,300                         | \$ 81              | 0.24%                    | \$ 88,518    | \$ 110             | 0.25%                    |
| Investment securities available for sale:      |                                   |                    |                          |              |                    |                          |
| Taxable  | 240,404                           | 1,875              | 1.57%                    | 288,187      | 1,735              | 1.21%                    |
| Non-taxable <sup>(3)</sup>                     | 36,270                            | 304                | 1.69%                    | 36,308       | 269                | 1.49%                    |
| Total investment securities available for sale | 276,674                           | 2,179              | 1.59%                    | 324,495      | 2,004              | 1.24%                    |
| Investment securities trading                  | 3,478                             | 24                 | 1.39%                    | 1,933        | 15                 | 1.56%                    |
| Loans and leases <sup>(1)(2)(3)</sup>          | 1,575,165                         | 39,043             | 5.00%                    | 1,415,944    | 36,147             | 5.15%                    |
| Total interest-earning assets                  | 1,924,617                         | 41,327             | 4.33%                    | 1,830,890    | 38,276             | 4.22%                    |
| Cash and due from banks                        | 12,184                            |                    |                          | 13,080       |                    |                          |
| Allowance for loan and lease losses            | (15,918)                          |                    |                          | (14,659)     |                    |                          |
| Other assets                                   | 154,150                           |                    |                          | 150,953      |                    |                          |
| Total assets                                   | \$ 2,075,033                      |                    |                          | \$ 1,980,264 |                    |                          |
| <b>Liabilities:</b>                            |                                   |                    |                          |              |                    |                          |
| Savings, NOW, and market rate accounts         | \$ 955,186                        | 824                | 0.17%                    | \$ 972,544   | 924                | 0.19%                    |
| Wholesale deposits                             | 84,402                            | 262                | 0.63%                    | 46,435       | 98                 | 0.43%                    |
| Time deposits                                  | 130,850                           | 316                | 0.49%                    | 177,518      | 447                | 0.51%                    |
| Total interest-bearing deposits                | 1,170,438                         | 1,402              | 0.24%                    | 1,196,497    | 1,469              | 0.25%                    |
| Short-term borrowings                          | 15,167                            | 8                  | 0.11%                    | 12,672       | 7                  | 0.13%                    |
| Long-term FHLB advances and other borrowings   | 217,657                           | 1,527              | 1.41%                    | 149,573      | 1,264              | 1.70%                    |
| Total borrowings                               | 232,824                           | 1,535              | 1.33%                    | 162,245      | 1,271              | 1.58%                    |
| Total interest-bearing liabilities             | 1,403,262                         | 2,937              | 0.42%                    | 1,358,742    | 2,740              | 0.41%                    |
| Non-interest-bearing deposits                  | 415,810                           |                    |                          | 389,146      |                    |                          |
| Other liabilities                              | 20,948                            |                    |                          | 24,878       |                    |                          |
| Total non-interest-bearing liabilities         | 436,758                           |                    |                          | 414,024      |                    |                          |
| Total liabilities                              | 1,840,020                         |                    |                          | 1,772,766    |                    |                          |
| Shareholders equity                            | 235,013                           |                    |                          | 207,498      |                    |                          |
| Total liabilities and shareholders equity      | \$ 2,075,033                      |                    |                          | \$ 1,980,264 |                    |                          |
| Net interest spread                            |                                   |                    | 3.91%                    |              |                    | 3.81%                    |

|  |           |       |           |       |
|--|-----------|-------|-----------|-------|
| Effect of non-interest-bearing liabilities                                     |           | 0.11% |           | 0.10% |
| Tax equivalent net interest income and margin on earning assets <sup>(3)</sup> | \$ 38,390 | 4.02% | \$ 35,536 | 3.91% |
| Tax-equivalent adjustment <sup>(3)</sup>                                       | \$ 225    | 0.02% | \$ 204    | 0.02% |

(1) Nonaccrual loans have been included in average loan balances, but interest on nonaccrual loans has been excluded for purposes of determining interest income.

(2) Loans include portfolio loans and leases and loans held for sale.

(3) Tax rate used for tax-equivalent calculations is 35%.

#### Rate/Volume Analysis (tax equivalent basis\*)

The rate/volume analysis in the table below analyzes dollar changes in the components of interest income and interest expense as they relate to the change in balances (volume) and the change in interest rates (rate) of tax-equivalent net interest income for the three and six months ended June 30, 2014 as compared to the same periods in 2013, allocated by rate and volume. The change in interest income and/or expense due to both volume and rate has been allocated to changes in volume.

|  | 2014 Compared to 2013 |          |          |                  |          |          |
|--|-----------------------|----------|----------|------------------|----------|----------|
|  | Three Months Ended    |          |          | Six Months Ended |          |          |
|  | June 30,              |          |          | June 30,         |          |          |
|  | Volume                | Rate     | Total    | Volume           | Rate     | Total    |
| Interest income                            |                       |          |          |                  |          |          |
| Interest-bearing deposits with other banks | \$ 7                  | \$ (4)   | \$ 3     | \$ (26)          | \$ (3)   | \$ (28)  |
| Investment securities                      | (154)                 | 220      | 66       | (276)            | 460      | 184      |
| Loans and leases                           | 2,183                 | (524)    | 1,659    | 4,068            | (1,172)  | 2,896    |
| Total interest income                      | \$ 2,036              | \$ (308) | \$ 1,728 | \$ 3,766         | \$ (715) | \$ 3,051 |
| Interest expense:                          |                       |          |          |                  |          |          |
| Savings, NOW and market rate accounts      | \$ (3)                | \$ (22)  | \$ (25)  | \$ (14)          | \$ (86)  | \$ (100) |
| Wholesale non-maturity deposits            | 9                     | (2)      | 7        | 14               | (12)     | 2        |
| Time deposits                              | (46)                  | (13)     | (59)     | (118)            | (13)     | (131)    |
| Wholesale time deposits                    | 61                    | 35       | 96       | 100              | 62       | 162      |
| Borrowed funds**                           | 287                   | (101)    | 186      | 578              | (314)    | 264      |
| Total interest expense                     | 308                   | (103)    | 205      | 560              | (363)    | 197      |
| Interest differential                      | \$ 1,728              | \$ 205   | \$ 1,523 | \$ 3,206         | \$ (352) | \$ 2,854 |

\* The tax rate used in the calculation of the tax equivalent income is 35%.

\*\* Borrowed funds include subordinated debentures, short-term borrowings and Federal Home Loan Bank ( FHLB ) advances and other borrowings.



**Table of Contents****Tax Equivalent Net Interest Margin**

The Corporation's tax-equivalent net interest margin increased 5 basis points to 4.03% for the three months ended June 30, 2014, from 3.98% for the same period in 2013. The increase in the tax-equivalent net interest margin was primarily driven by volume increases in interest-earning assets. Average interest-earning assets increased \$130.6 million, while average interest-bearing liabilities increased by \$82.3 million. The increase in average interest-earning assets between periods was largely related to a \$172.3 million increase in average portfolio loans, partially offset by a \$53.9 million decrease in available for sale investment securities. The yield on loans for the three months ended June 30, 2014 declined by 13 basis points from the same period in 2013, while the yield on available for sale investment securities increased by 34 basis points increase in between the three month periods ended June 30, 2013 and June 30, 2014. The increase in rate paid on average interest-bearing liabilities was primarily related to a \$76.2 million increase in average borrowings. The increase in long-term borrowings as well as the cash flows from available for sale investment securities were used to fund loan growth.

The Corporation's tax-equivalent net interest margin increased 11 basis points to 4.02% for the six months ended June 30, 2014, from 3.91% for the same period in 2013. Average interest-earning assets increased \$93.7 million, while average interest-bearing liabilities increased by \$44.5 million. The increase in average interest-earning assets between periods was largely related to a \$159.2 million increase in average portfolio loans, partially offset by a \$47.8 million decrease in available for sale investment securities. The yield on loans for the six months ended June 30, 2014 declined by 15 basis points compared to the same period in 2013. However, this reduction was offset by a 35 basis point increase in yield on available for sale investment securities between six month periods ended June 30, 2013 and June 30, 2014.

The tax-equivalent net interest margin and related components for the past five consecutive quarters are shown in the table below:

| Quarter                      | Interest-Earning Asset Yield | Interest-Bearing Liability Cost | Net Interest Spread | Effect of Non-Interest Bearing Sources | Net Interest Margin |
|------------------------------|------------------------------|---------------------------------|---------------------|--|---------------------|
| 2 <sup>nd</sup> Quarter 2014 | 4.34%                        | 0.42%                           | 3.92%               | 0.11%                                  | 4.03%               |
| 1 <sup>st</sup> Quarter 2014 | 4.32%                        | 0.42%                           | 3.90%               | 0.12%                                  | 4.02%               |
| 4 <sup>th</sup> Quarter 2013 | 4.33%                        | 0.40%                           | 3.93%               | 0.10%                                  | 4.03%               |
| 3 <sup>rd</sup> Quarter 2013 | 4.33%                        | 0.38%                           | 3.95%               | 0.10%                                  | 4.05%               |
| 2 <sup>nd</sup> Quarter 2013 | 4.27%                        | 0.39%                           | 3.88%               | 0.10%                                  | 3.98%               |

**Interest Rate Sensitivity**

The Corporation actively manages its interest rate sensitivity position. The objectives of interest rate risk management are to control exposure of net interest income to risks associated with interest rate movements and to achieve sustainable growth in net interest income. The Corporation's Asset Liability Committee (ALCO), using policies and procedures approved by the Corporation's Board of Directors, is responsible for the management of the Corporation's interest rate sensitivity position. The Corporation manages interest rate sensitivity by changing the mix, pricing and re-pricing characteristics of its assets and liabilities, through the management of its investment portfolio, its offerings of loan and selected deposit terms and through wholesale funding. Wholesale funding consists of multiple sources including borrowings from the FHLB, the Federal Reserve Bank of Philadelphia's discount window, certificates of deposit from institutional brokers, Certificate of Deposit Account Registry Service (CDARS), Insured Network Deposit (IND) Program, Charity Deposits Corporation (CDC), Insured Cash Sweep (ICS) and Pennsylvania Local

Government Investment Trust ( PLGIT ).

The Corporation uses several tools to manage its interest rate risk including interest rate sensitivity analysis, or gap analysis, market value of portfolio equity analysis, interest rate simulations under various rate scenarios and tax-equivalent net interest margin reports. The results of these reports are compared to limits established by the Corporation's ALCO policies and appropriate adjustments are made if the results are outside the established limits.

The following table demonstrates the annualized result of an interest rate simulation and the estimated effect that a parallel interest rate shift, or shock, in the yield curve and subjective adjustments in deposit pricing, might have on the Corporation's projected net interest income over the next 12 months.

This simulation assumes that there is no growth in interest-earning assets or interest-bearing liabilities over the next twelve months. The changes to net interest income shown below are in compliance with the Corporation's policy guidelines.

### Summary of Interest Rate Simulation

|                   | Change in Net Interest<br>Income Over the<br>Twelve<br>Months Beginning<br>After |            | Change in Net Interest<br>Income Over the<br>Twelve<br>Months Beginning<br>After |            |
|-------------------|--|------------|--|------------|
|                   | June 30, 2014  |            | December 31, 2013  |            |
|                   | Amount   | Percentage | Amount   | Percentage |
| +300 basis points | \$ 4,804   | 6.35%      | \$ 6,289   | 8.19%      |
| +200 basis points | \$ 1,531   | 4.21%      | \$ 3,537   | 4.61%      |
| +100 basis points | \$ 191   | 0.25%      | \$ 1,146   | 1.49%      |
| -100 basis points | \$ (2,051)   | (2.71)%    | \$ (1,868)   | (2.43)%    |

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The above interest rate simulation suggests that the Corporation's balance sheet is slightly asset sensitive as of June 30, 2014 in the +100 basis point scenario, demonstrating that a 100 basis point increase in interest rates would have a small, but positive impact on net interest income over the next 12 months. The Corporation's balance sheet is more asset sensitive in the other rate increase and decrease scenarios. It should be noted, however, that the balance sheet is less asset sensitive, in a rising-rate environment, as of June 30, 2014 than it was as of December 31, 2013. This change in sensitivity is primarily related to a revision in the assumptions used for determining interest rate increases on non-maturity deposits in a rising-rate environment. The ALCO reviewed the model's assumptions during the first quarter of 2014 and determined that a more reactive approach to adjusting deposit rates in rising-rate scenarios was appropriate, as the ongoing low-rate environment may have impacted customer behavior by heightening their sensitivity to rising rates.

The interest rate simulation is an estimate based on assumptions, which are derived from past behavior of customers, along with expectations of future behavior relative to interest rate changes. In today's uncertain economic environment and the current extended period of very low interest rates, the reliability of the Corporation's assumptions in the interest rate simulation model is more uncertain than in other periods. Actual customer behavior may be significantly different than expected behavior, which could cause an unexpected outcome and may result in lower net interest income.

**Gap Analysis**

The interest sensitivity, or gap analysis, shows interest rate risk by identifying re-pricing gaps in the Corporation's balance sheet. All assets and liabilities are categorized in the following table according to their behavioral sensitivity, which is usually the earliest of either: re-pricing, maturity, contractual amortization, prepayments or likely call dates. Non-maturity deposits, such as NOW, savings and money market accounts are spread over various time periods based on the expected sensitivity of these rates considering liquidity and the investment preferences of the Corporation. Non-rate-sensitive assets and liabilities are placed in a separate period. Capital is spread over time periods to reflect the Corporation's view of the maturity of these funds.

The following table presents the Corporation's interest rate sensitivity position or gap analysis as of June 30, 2014:

| <i>(dollars in millions)</i>                 | <b>0 to 90<br/>Days</b> | <b>91 to 365<br/>Days</b> | <b>1 - 5<br/>Years</b> | <b>Over<br/>5<br/>Years</b> | <b>Non-Rate<br/>Sensitive</b> | <b>Total</b>      |
|--|-------------------------|---------------------------|------------------------|-----------------------------|-------------------------------|-------------------|
| <b>Assets:</b>                               |                         |                           |                        |                             |                               |                   |
| Interest-bearing deposits with banks         | \$ 85.9                 | \$                        | \$                     | \$                          | \$                            | \$ 85.9           |
| Investment securities available for sale     | 40.8                    | 62.4                      | 116.0                  | 47.2                        |                               | 266.4             |
| Investment securities trading                | 3.6                     |                           |                        |                             |                               | 3.6               |
| Loans and leases <sup>(1)</sup>              | 484.0                   | 190.6                     | 696.4                  | 246.1                       |                               | 1,617.1           |
| Allowance for loan and lease losses          |                         |                           |                        |                             | (15.5)                        | (15.5)            |
| Cash and due from banks                      |                         |                           |                        |                             | 17.0                          | 17.0              |
| Other assets                                 |                         |                           |                        |                             | 156.7                         | 156.7             |
| <b>Total assets</b>                          | <b>\$ 614.3</b>         | <b>\$ 253.0</b>           | <b>\$ 812.4</b>        | <b>\$ 293.3</b>             | <b>\$ 158.2</b>               | <b>\$ 2,131.2</b> |
| <b>Liabilities and shareholders' equity:</b> |                         |                           |                        |                             |                               |                   |
| Demand, non-interest-bearing                 | \$ 27.2                 | \$ 81.6                   | \$ 116.9               | \$ 211.0                    | \$                            | \$ 436.7          |

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|   |                 |                  |                 |                 |                |                   |
|---|-----------------|------------------|-----------------|-----------------|----------------|-------------------|
| Savings, NOW and market rate  | 68.4            | 205.3            | 476.0           | 217.9           |                | 967.6             |
| Time deposits   | 34.9            | 61.5             | 27.2            |                 |                | 123.6             |
| Wholesale non-maturity deposits   | 41.8            |                  |                 |                 |                | 41.8              |
| Wholesale time deposits   | 3.1             | 1.0              | 46.1            |                 |                | 50.2              |
| Short-term borrowings   | 13.3            |                  |                 |                 |                | 13.3              |
| Long-term FHLB advances and other borrowings  | 50.8            | 10.9             | 166.0           | 5.4             |                | 233.1             |
| Other liabilities   |                 |                  |                 |                 | 21.5           | 21.5              |
| Shareholders equity   | 8.7             | 26.1             | 139.1           | 69.5            |                | 243.4             |
| <b>Total liabilities and shareholders equity</b>  | <b>\$ 248.2</b> | <b>\$ 386.4</b>  | <b>\$ 971.3</b> | <b>\$ 503.8</b> | <b>\$ 21.5</b> | <b>\$ 2,131.2</b> |
| <b>Interest-earning assets</b>  | <b>\$ 614.3</b> | <b>\$ 253.0</b>  | <b>\$ 812.4</b> | <b>\$ 293.3</b> | <b>\$</b>      | <b>\$ 1,973.0</b> |
| <b>Interest-bearing liabilities</b>   | <b>212.3</b>    | <b>278.7</b>     | <b>715.3</b>    | <b>223.3</b>    | <b></b>        | <b>1,429.6</b>    |
| <b>Difference between interest-earning assets and interest-bearing liabilities</b>            | <b>\$ 402.0</b> | <b>\$ (25.7)</b> | <b>\$ 97.1</b>  | <b>\$ 70.0</b>  | <b>\$</b>      | <b>\$ 543.4</b>   |
| <b>Cumulative difference between interest earning assets and interest-bearing liabilities</b> | <b>\$ 402.0</b> | <b>\$ 376.3</b>  | <b>\$ 473.4</b> | <b>\$ 543.4</b> | <b>\$</b>      | <b>\$ 543.4</b>   |
| <b>Cumulative earning assets as a % of cumulative interest bearing liabilities</b>            | <b>289%</b>     | <b>177%</b>      | <b>139%</b>     | <b>139%</b>     | <b></b>        | <b></b>           |

(1) *Loans include portfolio loans and leases and loans held for sale.*

The table above indicates that the Corporation is asset-sensitive in the immediate to 90-day time frame and may experience an increase in net interest income during that time period if rates rise. Conversely, if rates decline, net interest income may decline. It should be noted that the gap analysis is only one tool used to measure interest rate sensitivity and should be used in conjunction with other measures such as the interest rate simulation discussed above. The gap analysis measures the timing of changes in rate, but not the true weighting of any specific component of the Corporation's balance sheet. The asset-sensitive position reflected in this gap analysis is similar to the Corporation's position at March 31, 2014 and December 31, 2013.

#### PROVISION FOR LOAN AND LEASE LOSSES

For the three months ended June 30, 2014, the Corporation recorded a \$100 thousand release from Allowance as compared to a \$1 million Provision for the same period in 2013. For the six months ended June 30, 2014, the Corporation recorded a \$650 thousand



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Provision as compared to \$1.8 million for the same period in 2013. Lower net charge-offs, reductions in nonperforming loans, upgrades of internally-assigned risk ratings of the Corporation's loan portfolio as well as improvements to certain qualitative factors considered in the calculation of the Allowance contributed to the decreases in the Provision between the respective periods. For a general discussion of the allowance for loan and lease losses, and our policies related thereto, refer to page 41 of the Corporation's 2013 Annual Report.

**Asset Quality and Analysis of Credit Risk**

As of June 30, 2014, total nonperforming loans and leases decreased by \$2.1 million, to \$8.4 million, representing 0.52% of portfolio loans and leases, as compared to \$10.5 million, or 0.68% of portfolio loans and leases as of December 31, 2013. The decrease was comprised of a \$744 thousand decrease in nonperforming residential mortgage loans, an \$810 decrease in nonperforming commercial and industrial loans, a \$361 thousand decrease in nonperforming construction loans and a \$182 thousand decrease in nonperforming commercial mortgages. The decrease in nonperforming loans and leases was comprised of payoffs and returns to performing status of \$2.6 million, full and partial charge-offs of \$199 thousand, and foreclosure of loans to OREO of \$875 thousand. These decreases were partially offset by \$1.5 million of loans and leases that became non-performing during the period.

As of June 30, 2014, the Allowance of \$15.5 million represented 0.96% of portfolio loans and leases, a 4 basis point decrease from 1.00% as of December 31, 2013.

As of June 30, 2014, the Corporation had OREO valued at \$853 thousand, as compared to \$855 thousand as of December 31, 2013. The balance as of June 30, 2014 was comprised of four residential properties. All properties are recorded at the lower of cost or fair value less cost to sell. Proceeds from the sale of OREO properties totaled \$1.1 million for both the three and six months ended June 30, 2014. Gain on sale of OREO properties totaled \$220 thousand for both the three and six months ended June 30, 2014.

As of June 30, 2014, the Corporation had \$9.1 million of troubled debt restructurings ( TDRs ), of which \$7.5 million were in compliance with the modified terms, and hence, excluded from non-performing loans and leases. As of December 31, 2013, the Corporation had \$9.0 million of TDRs, of which \$7.3 million were in compliance with the modified terms, and as such, were excluded from non-performing loans and leases.

As of June 30, 2014, the Corporation had a recorded investment of \$15.7 million of impaired loans and leases which included \$9.1 million of TDRs. Impaired loans and leases are those for which it is probable that the Corporation will not be able to collect all scheduled principal and interest in accordance with the original terms of the loans and leases. Impaired loans and leases as of December 31, 2013 totaled \$17.6 million, which included \$9.0 million of TDRs. Refer to Note 4H in the Notes to Consolidated Financial Statements for more information regarding the Corporation's impaired loans and leases.

The Corporation continues to be diligent in its credit underwriting process and proactive with its loan review process, including the engagement of the services of an independent outside loan review firm, which helps identify developing credit issues. These proactive steps include the procurement of additional collateral (preferably outside the current loan structure) whenever possible and frequent contact with the borrower. The Corporation believes that timely identification of credit issues and appropriate actions early in the process serve to mitigate overall losses.

**Nonperforming Assets and Related Ratios**

| <i>(dollars in thousands)</i>   | June 30,<br>2014 | December 31,<br>2013 |
|---|------------------|----------------------|
| <b>Non-Performing Assets:</b>   |                  |                      |
| Non-accrual loans and leases  | \$ 8,388         | \$ 10,530            |
| Other real estate owned   | 853              | 855                  |
| Total non-performing assets   | \$ 9,241         | \$ 11,385            |
| <b>Troubled Debt Restructures:</b>                                      |                  |                      |
| TDRs included in non-performing loans                                   | \$ 1,597         | \$ 1,699             |
| TDRs in compliance with modified terms                                  | 7,487            | 7,277                |
| Total TDRs  | \$ 9,084         | \$ 8,976             |
| <b>Loan and Lease quality indicators:</b>                               |                  |                      |
| Allowance for loan and lease losses to non-performing loans and leases  | 184.4%           | 147.3%               |
| Non-performing loans and leases to total portfolio loans and leases     | 0.52%            | 0.68%                |
| Allowance for loan and lease losses to total portfolio loans and leases | 0.96%            | 1.00%                |
| Non-performing assets to total assets                                   | 0.43%            | 0.55%                |
| Total portfolio loans and leases  | \$ 1,615,542     | \$ 1,547,185         |
| Allowance for loan and lease losses                                     | \$ 15,470        | \$ 15,515            |

**NON-INTEREST INCOME****Three Months Ended June 30, 2014 Compared to the Same Period in 2013**

Non-interest income for the three months ended June 30, 2014 was \$12.8 million, a decrease of \$186 thousand from the same period in 2013. The decrease was largely related to the \$955 thousand, or 64.0%, decrease in gain on sale of residential mortgage loans between the three month periods ended June 30, 2014 and June 30, 2013. During the three months ended June 30, 2014, the volume of residential mortgage loans sold to the secondary market decreased, with residential mortgages sold totaling \$15.2 million, as compared

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to \$46.5 million during the same period in 2013, a 67.3% decrease. This decline was a result of the end of the mortgage refinancing boom which wound down during the first half of 2013. Partially offsetting this decrease in non-interest income was a \$405 thousand increase in revenue from wealth management services for the three months ended June 30, 2014 as compared to the same period in 2013. Wealth Management Division assets under management, administration, supervision and brokerage as of June 30, 2014 were \$7.6 billion, an increase of \$715 million, or 10.4%, from June 30, 2013. The increase was driven by organic growth related to strategic initiatives within the division, along with market appreciation and other new business between the dates. Also contributing to non-interest income for the three months ended June 30, 2014 was \$220 thousand in gain on sale of OREO, an increase of \$361 thousand from the same period in 2013, in which a loss of \$141 thousand was recorded. Four properties were sold during the second quarter of 2014.

**Six Months Ended June 30, 2014 Compared to the Same Period in 2013**

Non-interest income for the six months ended June 30, 2014 was \$23.9 million, a decrease of \$837 thousand from the same period in 2013. The decrease was largely related to the \$2.1 million, or 71.4%, decline in gain on sale of residential mortgage loans between the six month periods ended June 30, 2014 and June 30, 2013. Partially offsetting this decrease in non-interest income was a \$969 thousand increase in revenue from wealth management services for the six months ended June 30, 2014 as compared to the same period in 2013. In addition, gain on sale of OREO increased by \$413 thousand for the six months ended June 30, 2014, as compared to the same period in 2013, in which a loss of \$193 thousand was recorded.

The following table provides supplemental information regarding mortgage loan originations and sales:

|  | As of or for the            |          | As of or for the          |          |
|--|-----------------------------|----------|---------------------------|----------|
|  | Three Months Ended June 30, |          | Six Months Ended June 30, |          |
| (dollars in millions)                        | 2014                        | 2013     | 2014                      | 2013     |
| Residential mortgage loans held in portfolio | \$ 310.5                    | \$ 280.7 | \$ 310.5                  | \$ 280.7 |
| Mortgage originations                        | \$ 32.1                     | \$ 55.1  | \$ 47.9                   | \$ 120.2 |
| <b>Mortgage loans sold:</b>                  |                             |          |                           |          |
| Servicing retained                           | \$ 15.2                     | \$ 46.2  | \$ 24.2                   | \$ 97.6  |
| Servicing released                           |                             | 0.3      | 0.2                       | 0.5      |
| Total mortgage loans sold                    | \$ 15.2                     | \$ 46.5  | \$ 24.4                   | \$ 98.1  |
| Percent servicing-retained                   | 100.0%                      | 99.3%    | 99.4%                     | 99.5%    |
| Percent servicing-released                   |                             | % 0.7%   | 0.6%                      | 0.5%     |
| Percent of originated mortgage loans sold    | 47.2%                       | 84.6%    | 50.9%                     | 81.6%    |
| Mortgage servicing rights ( MSR )            | \$ 4.8                      | \$ 4.8   | \$ 4.8                    | \$ 4.8   |
| Net gain on sale of loans                    | \$ 0.5                      | \$ 1.5   | \$ 0.9                    | \$ 3.0   |
| Loan servicing and other fees                | \$ 0.4                      | \$ 0.4   | \$ 0.9                    | \$ 0.9   |
| Amortization of MSRs                         | \$ 0.1                      | \$ 0.2   | \$ 0.2                    | \$ 0.4   |
| Net (recovery) impairment of MSRs            | \$                          | \$ (0.1) | \$                        | \$ 0.0   |
| Yield on loans sold (includes MSR income)    | 3.54%                       | 3.20%    | 3.53%                     | 3.07%    |
| Loans serviced for others <sup>(1)</sup>     | \$ 622.8                    | \$ 623.5 | \$ 622.8                  | \$ 623.5 |

(1) Includes residential mortgage, commercial mortgage, and commercial and industrial loans.

The following table provides details of other operating income for the three and six months ended June 30, 2014 and 2013:

| <i>(dollars in thousands)</i> | <b>Three Months<br/>Ended June 30,</b> |                 | <b>Six Months<br/>Ended<br/>June 30,</b> |                 |
|-------------------------------|--|-----------------|--|-----------------|
|                               | 2014                                   | 2013            | 2014                                     | 2013            |
| Merchant interchange fees     | \$ 236                                 | \$ 205          | \$ 449                                   | \$ 395          |
| Commissions and fees          | 166                                    | 165             | 304                                      | 203             |
| Safe deposit box rentals      | 99                                     | 97              | 199                                      | 194             |
| Insurance commissions         | 131                                    | 147             | 240                                      | 267             |
| Other investment income       | 332                                    | 164             | 375                                      | 181             |
| Title insurance income        |  | 44              |  | 194             |
| Rental income                 | 42                                     | 50              | 94                                       | 104             |
| Miscellaneous other income    | 252                                    | 497             | 375                                      | 656             |
| <b>Other operating income</b> | <b>\$ 1,258</b>                        | <b>\$ 1,369</b> | <b>\$ 2,036</b>                          | <b>\$ 2,194</b> |

**Table of Contents****NON-INTEREST EXPENSE****Three Months Ended June 30, 2014 Compared to the Same Period in 2013**

Non-interest expense for the three months ended June 30, 2014 increased \$102 thousand, to \$20.6 million, as compared to \$20.5 million for the same period in 2013. Contributing to this increase were increases of \$608 thousand in salaries and \$250 thousand in professional fees between the periods. The increase in salaries was related to increases in information services staffing, the establishment of two senior management level positions, and the payment of severance benefits and annual salary increases. The increase in professional fees was primarily related to the engagement of consultants to assist in connection with ongoing infrastructure enhancement projects. Offsetting these increases was a \$403 thousand decrease in employee benefits expense, as better-than-expected returns on pension assets in 2013 along with an increase in the discount rate used to calculate periodic pension costs helped reduce costs associated with the Corporation's retirement plans. In addition, due diligence and merger-related costs decreased \$311 thousand between periods, as those merger-integration costs associated with the MidCoast Bancorp, Inc. merger transaction, which was terminated in August of 2013, were not present during the second quarter on 2014.

**Six Months Ended June 30, 2014 Compared to the Same Period in 2013**

Non-interest expense for the six months ended June 30, 2014 decreased \$1.2 million, to \$39.5 million, as compared to \$40.8 million for the same period in 2013. Contributing to this decrease were decreases of \$761 thousand in due diligence and merger-related costs, which had been associated with the MidCoast Bancorp, Inc. merger mentioned above, as well as the absence of early extinguishment of debt costs that had been incurred in 2013 related to early payment of certain FHLB borrowings and subordinated debt obligations. Partially offsetting these decreases were increases of \$238 thousand in salaries and \$268 thousand in professional fees related to the ongoing infrastructure enhancement projects discussed above.

The following table provides details of other operating expenses for the three and six months ended June 30, 2014 and 2013:

| <i>(dollars in thousands)</i>    | <b>Three Months</b>   |                       | <b>Six Months</b>     |                       |
|----------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                                  | <b>Ended June 30,</b> | <b>Ended June 30,</b> | <b>Ended June 30,</b> | <b>Ended June 30,</b> |
|                                  | 2014                  | 2013                  | 2014                  | 2013                  |
| Information technology           | \$ 697                | \$ 732                | \$ 1,346              | \$ 1,513              |
| Loan processing                  | 122                   | 281                   | 361                   | 602                   |
| Other taxes                      | 24                    | 17                    | 36                    | 37                    |
| Temporary help and recruiting    | 246                   | 317                   | 433                   | 817                   |
| Telephone and data lines         | 353                   | 364                   | 656                   | 783                   |
| Travel and entertainment         | 200                   | 162                   | 328                   | 286                   |
| Stationary and supplies          | 127                   | 119                   | 232                   | 271                   |
| Postage                          | 133                   | 103                   | 261                   | 261                   |
| Director fees                    | 135                   | 147                   | 260                   | 258                   |
| Investment portfolio maintenance | 78                    | 95                    | 174                   | 191                   |
| Dues and subscriptions           | 93                    | 90                    | 175                   | 178                   |
| Insurance                        | 191                   | 177                   | 395                   | 369                   |
| Deferred compensation expense    | 174                   | 69                    | 183                   | 234                   |
| Outsourced services              | 108                   | 102                   | 216                   | 213                   |

|                             |          |          |          |          |
|-----------------------------|----------|----------|----------|----------|
| Miscellaneous other expense | 509      | 462      | 1,119    | 911      |
| Other operating expense     | \$ 3,190 | \$ 3,237 | \$ 6,175 | \$ 6,924 |

## INCOME TAXES

Income tax expense for the three months ended June 30, 2014 was \$4.1 million, as compared to \$3.1 million for the same period in 2013, reflecting an increase in the effective tax rate from 33.1% for the second quarter of 2013 to 34.9% for the second quarter of 2014. The increase in effective tax rate was primarily related to a \$152 thousand tax credit recorded in the three months ended June 30, 2013 in connection with a change-in-method election related to the Corporation's deferred compensation plans.

Income tax expense for the six months ended June 30, 2014 was \$7.6 million, as compared to \$5.9 million for the same period in 2013, reflecting an increase in the effective tax rate from 33.9% for the six months ended June 30, 2013 to 34.7% for the same period in 2014. The 80 basis point increase in effective tax rate was primarily related to the tax credit recorded in the six months ended June 30, 2013 in connection with a change-in-method election related to the Corporation's deferred compensation plans.

## BALANCE SHEET ANALYSIS

Total assets as of June 30, 2014 of \$2.13 billion increased \$69.6 million, or 3.4%, from \$2.06 billion as of December 31, 2013. Interest-bearing deposits with banks increased \$18.3 million, or 27.1%, portfolio loans and leases increased \$68.4 million, or 4.4%, available for sale investments decreased \$19.4 million, or 6.8%, total deposits increased \$28.6 million, or 1.8%, and long-term FHLB advances and other borrowings increased \$27.5 million, or 13.4%, between the two dates. The increased loan demand was funded through redeployment of cash flows from the investment portfolio, as well as increases in long-term FHLB advances and deposit inflows.

**Table of Contents****Loans and Leases**

The table below compares the portfolio loans and leases outstanding at June 30, 2014 to December 31, 2013:

| <i>(dollars in thousands)</i>    | June 30, 2014 |                      | December 31, 2013 |                      | Change    |         |
|----------------------------------|---------------|----------------------|-------------------|----------------------|-----------|---------|
|                                  | Balance       | Percent of Portfolio | Balance           | Percent of Portfolio | Amount    | Percent |
| Commercial mortgage              | \$ 666,924    | 41.3%                | \$ 625,341        | 40.4%                | \$ 41,583 | 6.6%    |
| Home equity lines & loans        | 185,593       | 11.5%                | 189,571           | 12.3%                | (3,978)   | (2.1)%  |
| Residential mortgage             | 310,491       | 19.2%                | 300,243           | 19.4%                | 10,248    | 3.4%    |
| Construction                     | 55,051        | 3.4%                 | 46,369            | 3.0%                 | 8,682     | 18.7%   |
| Commercial and industrial        | 334,474       | 20.7%                | 328,459           | 21.2%                | 6,015     | 1.8%    |
| Consumer                         | 18,907        | 1.2%                 | 16,926            | 1.1%                 | 1,981     | 11.7%   |
| Leases                           | 44,102        | 2.7%                 | 40,276            | 2.6%                 | 3,826     | 9.5%    |
| Total portfolio loans and leases | 1,615,542     | 100.0%               | 1,547,185         | 100.0%               | 68,357    | 4.4%    |
| Loans held for sale              | 1,631         |                      | 1,350             |                      | 281       | 20.8%   |
| Total loans and leases           | \$ 1,617,173  |                      | \$ 1,548,535      |                      | \$ 68,638 | 4.4%    |

Overall, portfolio loans and leases increased by \$68.4 million, or 4.4%, as of June 30, 2014 as compared to December 31, 2013. As detailed in the table above, the most significant increase was seen in the commercial mortgage and residential mortgage segments of the portfolio.

The Corporation continues to focus its business development efforts on building banking relationships with local businesses, not-for-profit companies and strong credit quality individuals. The Corporation believes there are opportunities for new business with credit-worthy borrowers who are not satisfied with their current lender in the commercial real estate market within our primary trading area.

**Cash and Investment Securities**

As of June 30, 2014, liquidity remained strong as the Corporation had \$71.0 million of cash balances at the Federal Reserve and \$14.6 million in other interest-bearing accounts, along with significant borrowing capacity as discussed in the Liquidity section below.

Investment securities available for sale as of June 30, 2014 totaled \$266.4 million, as compared to \$285.8 million as of December 31, 2013, as cash flows from investment maturities were utilized to fund loan originations. The \$19.4 million decrease in investment securities available for sale during the six months ended June 30, 2014 was concentrated in the mortgage-related and U.S. Government and agencies segments of the portfolio, which decreased \$12.8 million and \$6.2 million, respectively, between June 30, 2014 and December 31, 2013. The Corporation has remained focused on maintaining liquidity and reducing interest rate risk by favoring investments that have both strong credit quality and a reasonable yield, while still limiting extension risk.

**Deposits and Borrowings**

Deposits and borrowings as of June 30, 2014 and December 31, 2013 were as follows:

| <i>(dollars in thousands)</i>   | June 30, 2014       |                     | December 31, 2013   |                     | Change           |             |
|---------------------------------|---------------------|---------------------|---------------------|---------------------|------------------|-------------|
|                                 | Balance             | Percent of Deposits | Balance             | Percent of Deposits | Amount           | Percent     |
| Interest-bearing checking       | \$ 263,247          | 16.3%               | \$ 266,787          | 16.8%               | \$ (3,540)       | (1.3)%      |
| Money market                    | 559,070             | 34.5%               | 544,310             | 34.2%               | 14,760           | 2.7%        |
| Savings                         | 145,312             | 9.0%                | 135,240             | 8.5%                | 10,072           | 7.4%        |
| Wholesale non-maturity deposits | 41,840              | 2.6%                | 42,936              | 2.7%                | (1,096)          | (2.6)%      |
| Wholesale time deposits         | 50,152              | 3.1%                | 34,640              | 2.2%                | 15,512           | 44.8%       |
| Retail time deposits            | 123,572             | 7.6%                | 140,794             | 8.8%                | (17,222)         | (12.2)%     |
| Interest-bearing deposits       | 1,183,193           | 73.0%               | 1,164,707           | 73.2%               | 18,486           | 1.6%        |
| Non-interest-bearing deposits   | 436,739             | 27.0%               | 426,640             | 26.8%               | 10,099           | 2.4%        |
| <b>Total deposits</b>           | <b>\$ 1,619,932</b> | <b>100.0%</b>       | <b>\$ 1,591,347</b> | <b>100.0%</b>       | <b>\$ 28,585</b> | <b>1.8%</b> |

| <i>(dollars in thousands)</i>                | June 30, 2014     |                       | December 31, 2013 |                       | Change           |              |
|--|-------------------|-----------------------|-------------------|-----------------------|------------------|--------------|
|  | Balance           | Percent of Borrowings | Balance           | Percent of Borrowings | Amount           | Percent      |
| Short-term borrowings                        | \$ 13,320         | 5.4%                  | \$ 10,891         | 5.0%                  | \$ 2,429         | 22.3%        |
| Long-term FHLB advances and other borrowings | 233,132           | 94.6%                 | 205,644           | 95.0%                 | 27,488           | 13.4%        |
| <b>Borrowed funds</b>                        | <b>\$ 246,452</b> | <b>100.0%</b>         | <b>\$ 216,535</b> | <b>100.0%</b>         | <b>\$ 29,917</b> | <b>13.8%</b> |

Total deposits as of June 30, 2014 increased \$28.6 million from the levels present as of December 31, 2013. As detailed in the table above, the most significant increases were in the money market, savings, wholesale time and non-interest-bearing deposit categories. These increases were partially offset by decreases in the retail time deposit and interest-bearing checking categories.

Long-term FHLB advances and other borrowings increased by \$27.5 million during the six months ended June 30, 2014 as loan demand required increased borrowings to supplement the increase in deposits.



**Table of Contents****Capital**

Consolidated shareholder's equity of the Corporation was \$243.4 million, or 11.4% of total assets as of June 30, 2014, as compared to \$229.9 million, or 11.2% of total assets as of December 31, 2013. The following table presents the Corporation's and Bank's capital ratios and the minimum capital requirements to be considered "Well Capitalized" by regulators as of June 30, 2014 and December 31, 2013:

| <i>(dollars in thousands)</i>  | Actual     |        | Minimum to be Well Capitalized |        |
|--|------------|--------|--------------------------------|--------|
|  | Amount     | Ratio  | Amount                         | Ratio  |
| <b>June 30, 2014:</b>  |            |        |                                |        |
| Total (Tier II) capital to risk weighted assets                          |            |        |                                |        |
| Corporation  | \$ 213,267 | 12.79% | \$ 166,750                     | 10.00% |
| Bank   | 209,959    | 12.62% | 166,354                        | 10.00% |
| Tier I capital to risk weighted assets                                   |            |        |                                |        |
| Corporation  | 197,638    | 11.85% | 100,050                        | 6.00%  |
| Bank   | 194,330    | 11.68% | 99,812                         | 6.00%  |
| Tier I Leverage ratio (Tier I capital to total quarterly average assets) |            |        |                                |        |
| Corporation  | 197,638    | 9.66%  | 102,294                        | 5.00%  |
| Bank   | 194,330    | 9.51%  | 102,202                        | 5.00%  |
| Tangible common equity to tangible assets                                |            |        |                                |        |
| Corporation  | 194,090    | 9.32%  |                                |        |
| Bank   | 190,782    | 9.18%  |                                |        |
| <b>December 31, 2013:</b>  |            |        |                                |        |
| Total (Tier II) capital to risk weighted assets                          |            |        |                                |        |
| Corporation  | \$ 200,667 | 12.55% | \$ 159,924                     | 10.00% |
| Bank   | 197,463    | 12.38% | 159,493                        | 10.00% |
| Tier I capital to risk weighted assets                                   |            |        |                                |        |
| Corporation  | 185,022    | 11.57% | 95,954                         | 6.00%  |
| Bank   | 181,818    | 11.40% | 95,696                         | 6.00%  |
| Tier I leverage ratio (Tier I capital to total quarterly average assets) |            |        |                                |        |
| Corporation  | 185,022    | 9.29%  | 99,543                         | 5.00%  |
| Bank   | 181,818    | 9.14%  | 99,424                         | 5.00%  |
| Tangible common equity to tangible assets                                |            |        |                                |        |
| Corporation  | 179,457    | 8.92%  |                                |        |
| Bank   | 176,254    | 8.78%  |                                |        |

Both the Corporation and the Bank exceed the capital levels to be considered "well capitalized" that are required by their respective regulators at the end of each period presented. The capital ratios as of June 30, 2014 for both the Bank and the Corporation have improved from their December 31, 2013 levels. These increases were the result of increases in retained earnings, issuance of shares (primarily through the exercise of stock options), and decreases in accumulated other comprehensive losses between the dates. Neither the Corporation nor the Bank is under any agreement with regulatory authorities which would have a material effect on liquidity, capital resources or operations of the

Corporation or the Bank. However, the final rules approved by the Federal Reserve on July 2, 2013, related to the Basel III regulatory capital reforms, which are further discussed in our 2013 Annual Report.

There is no official regulatory guideline for the tangible common equity to tangible asset ratio.

### **Shelf Registration Statement**

In April 2012, the Corporation filed a shelf registration statement (the **Shelf Registration Statement**) to replace its 2009 Shelf Registration Statement, which was set to expire in June 2012. This new Shelf Registration Statement allows the Corporation to raise additional capital through offers and sales of registered securities consisting of common stock, debt securities, warrants to purchase common stock, stock purchase contracts and units or units consisting of any combination of the foregoing securities. Using the prospectus in the Shelf Registration Statement, together with applicable prospectus supplements, the Corporation may sell, from time to time, in one or more offerings, such securities in a dollar amount up to \$150,000,000, in the aggregate.

### **Dividend Reinvestment and Stock Purchase Plan**

The Corporation has in place under its Shelf Registration Statement a Dividend Reinvestment and Stock Purchase Plan (the **Plan**), which was amended and restated on April 27, 2012 primarily to increase the number of shares which can be issued by the Corporation from 850,000 to 1,500,000 shares of registered common stock. The Plan allows for the grant of a request for waiver (**RFW**) above the Plan's maximum investment of \$120 thousand per account per year. An RFW is granted based on a variety of factors, including the Corporation's current and projected capital needs, prevailing market prices of the Corporation's common stock and general economic and market conditions.

The Plan is intended to allow both existing shareholders and new investors to easily and conveniently increase their investment in the Corporation without incurring many of the fees and commissions normally associated with brokerage transactions. For the six months ended June 30, 2014, the Corporation issued 1,159 shares and raised \$32 thousand through the Plan.

**Table of Contents****Liquidity**

The Corporation's liquidity position is managed on a daily basis as part of the daily settlement function and continuously as part of the formal asset liability management process. The Bank's liquidity is maintained by managing its core deposits as the primary source, purchasing federal funds, selling loans in the secondary market, borrowing from the FHLB and the Federal Reserve Bank, and purchasing and issuing wholesale certificates of deposit as its secondary sources.

Unused availability is detailed on the following table:

| <i>(dollars in millions)</i>                     | Available Funds     |                                     | Available Funds as   |                                     | Dollar Change | Percent Change |
|--|---------------------|-------------------------------------|----------------------|-------------------------------------|---------------|----------------|
|  | as of June 30, 2014 | Percent of Total Borrowing Capacity | of December 31, 2013 | Percent of Total Borrowing Capacity |               |                |
| Federal Home Loan Bank of Pittsburgh             | \$ 624.2            | 72.0%                               | \$ 628.4             | 74.7%                               | \$ (4.2)      | (0.7)%         |
| Federal Reserve Bank of Philadelphia             | 84.0                | 100.0%                              | 73.3                 | 100.0%                              | 10.7          | 14.6%          |
| Fed Funds Lines (six banks)                      | 64.0                | 100.0%                              | 64.0                 | 100.0%                              |               | %              |
| Revolving line of credit with correspondent bank | 3.0                 | 100.0%                              | 3.0                  | 100.0%                              |               | %              |
|  | \$ 775.2            | 76.2%                               | \$ 768.7             | 78.3%                               | \$ 6.5        | 0.9%           |

Quarterly, the ALCO reviews the Corporation's liquidity needs and reports its findings to the Risk Management Committee of the Corporation's Board of Directors.

The Corporation has an agreement with CDC to provide up to \$5 million, excluding accrued interest, of money market deposits at an agreed upon rate currently at 0.45%. The Corporation had \$5.2 million in balances as of June 30, 2014 under this program. The Corporation can request an increase in the agreement amount as it deems necessary. In addition, the Corporation has an agreement with IND to provide up to \$40 million, excluding accrued interest, of money market and NOW funds at an agreed upon interest rate equal to the current Fed Funds rate plus 20 basis points. The Corporation had \$34.5 million in balances as of June 30, 2014 under this program.

The Corporation continually evaluates the cost and mix of its retail and wholesale funding sources relative to earning assets and expected future earning-asset growth. The Corporation believes that with its current branch network, along with the available borrowing capacity at FHLB and other sources, it has sufficient capacity available to fund expected earning-asset growth.

**Discussion of Segments**

The Corporation has two principal segments as defined by FASB ASC 280, *Segment Reporting*. The segments are Banking and Wealth Management (see Note 10 in the accompanying Notes to Consolidated Financial Statements).

The Wealth Management segment, as discussed in the Non-Interest Income section above recorded a pre-tax segment profit (PTSP) of \$3.9 million and \$7.4 million for the three and six months ended June 30, 2014, respectively, as

compared to PTSP of \$3.5 million and \$6.3 million for the respective periods in 2013. The Wealth Management segment provided 33.4% and 33.9% of the Corporation's pre-tax profit for the three months ended June 30, 2014 and 2013, respectively and 36.9% and 36.0% of the Corporation's pre-tax profit for the six months ended June 30, 2014 and 2013, respectively.

The Banking Segment recorded a PTSP of \$7.8 million and \$14.5 million for the three and six months ended June 30, 2014, respectively, as compared to \$5.9 million and \$11.2 million for the respective periods in 2013. The Banking Segment provided 66.6% and 66.1% of the Corporation's pre-tax profit for the three months ended June 30, 2014 and 2013, respectively and 63.1% and 64.0% of the Corporation's pre-tax profit for the six months ended June 30, 2014 and 2013, respectively.

### **Off Balance Sheet Risk**

The Corporation is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the loan agreement. Total commitments to extend credit at June 30, 2014 were \$453.6 million, as compared to \$405.3 million at December 31, 2013.

Standby letters of credit are conditional commitments issued by the Bank to a customer for a third party. Such standby letters of credit are issued to support private borrowing arrangements. The credit risk involved in issuing standby letters of credit is similar to that involved in granting loan facilities to customers. The Corporation's obligation under standby letters of credit at June 30, 2014 amounted to \$23.7 million, as compared to \$21.2 million at December 31, 2013.

Estimated fair values of the Corporation's off-balance sheet instruments are based on fees and rates currently charged to enter into similar loan agreements, taking into account the remaining terms of the agreements and the counterparties credit standing. Since fees and rates charged for off-balance sheet items are at market levels when set, there is no material difference between the stated amount and the estimated fair value of off-balance sheet instruments.

**Table of Contents****Contractual Cash Obligations of the Corporation as of June 30, 2014:**

| <i>(dollars in millions)</i>                 | Total             | Within<br>1 Year  | 2<br>3 Years    | 4<br>5 Years    | After<br>5 Years |
|--|-------------------|-------------------|-----------------|-----------------|------------------|
| Deposits without a stated maturity           | \$ 1,446.2        | \$ 1,446.2        | \$              | \$              | \$               |
| Wholesale and retail time deposits           | 173.7             | 98.8              | 55.2            | 19.7            |                  |
| Short-term borrowings                        | 13.3              | 13.3              |                 |                 |                  |
| Long-term FHLB advances and other borrowings | 233.1             | 18.7              | 113.0           | 96.4            | 5.0              |
| Operating leases                             | 51.2              | 3.1               | 6.0             | 5.9             | 36.2             |
| Purchase obligations                         | 15.2              | 4.0               | 7.9             | 2.9             | 0.4              |
| Non-discretionary pension contributions      | 0.1               | 0.1               |                 |                 |                  |
| <b>Total</b>                                 | <b>\$ 1,932.8</b> | <b>\$ 1,584.2</b> | <b>\$ 182.1</b> | <b>\$ 124.9</b> | <b>41.6</b>      |

**Other Information****Effects of Inflation**

Inflation has some impact on the Corporation's operating costs. Unlike many industrial companies, however, substantially all of the Corporation's assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on the Corporation's performance than the general level of inflation. Over short periods of time, interest rates may not necessarily move in the same direction or in the same magnitude as prices of goods and services.

**Effects of Government Monetary Policies**

The earnings of the Corporation are and will be affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. An important function of the Federal Reserve Board is to regulate the money supply and interest rates. Among the instruments used to implement those objectives are open market operations in United States government securities and changes in reserve requirements against member bank deposits. These instruments are used in varying combinations to influence overall growth and distribution of bank loans, investments, and deposits, and their use may also affect rates charged on loans or paid for deposits.

The Corporation is a member of the Federal Reserve System and, therefore, the policies and regulations of the Federal Reserve Board have a significant effect on its deposits, loans and investment growth, as well as the rate of interest earned and paid, and are expected to affect the Corporation's operations in the future. The effect of such policies and regulations upon the future business and earnings of the Corporation cannot be predicted.

**Special Cautionary Notice Regarding Forward Looking Statements**

Certain of the statements contained in this Quarterly Report on Form 10-Q, including, without limitation, this Item 2 of Part I, may constitute forward-looking statements for the purposes of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, and may involve known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements of the Corporation to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. These forward-looking statements include statements with respect to the Corporation's financial goals, business plans,

business prospects, credit quality, credit risk, reserve adequacy, liquidity, origination and sale of residential mortgage loans, mortgage servicing rights, the effect of changes in accounting standards, and market and pricing trends loss. The words may, would, could, will, likely, expect, anticipate, intend, estimate, plan, forecast, similar expressions are intended to identify such forward-looking statements. The Corporation's actual results may differ materially from the results anticipated by the forward-looking statements due to a variety of factors, including without limitation:

the effect of future economic conditions on the Corporation and its customers, including economic factors which affect consumer confidence in the securities markets, wealth creation, investment and savings patterns, the real estate market, and the Corporation's interest rate risk exposure and credit risk;

changes in the securities markets with respect to the market values of financial assets and the stability of particular securities markets;

any future downgrades in the credit rating of the U.S. Government and federal agencies;

governmental monetary and fiscal policies, as well as legislation and regulatory changes;

results of examinations by the Federal Reserve Board, including the possibility that the Federal Reserve Board may, among other things, require us to increase our allowance for loan losses or to write down assets;

changes in accounting requirements or interpretations;

changes in existing statutes, regulatory guidance, legislation or judicial decisions that adversely affect our business, including changes in federal income tax or other tax regulations;

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the risks of changes in interest rates on the level and composition of deposits, loan demand, and the value of loan collateral and securities, as well as interest rate risk;

the effects of competition from other commercial banks, thrifts, mortgage companies, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money-market and mutual funds and other institutions operating in the Corporation's trade market area and elsewhere including institutions operating locally, regionally, nationally and internationally and such competitors offering banking products and services by mail, telephone, computer and the Internet;

any extraordinary events (such as natural disasters, acts of terrorism, wars or political conflicts);

the Corporation's need for capital;

the Corporation's success in continuing to generate new business in its existing markets, as well as its success in identifying and penetrating targeted markets and generating a profit in those markets in a reasonable time;

the Corporation's ability to continue to generate investment results for customers and the ability to continue to develop investment products in a manner that meets customers needs;

differences in the actual financial results, cost savings, and revenue enhancements associated with our acquisitions;

changes in consumer and business spending, borrowing and savings habits and demand for financial services in our investment products in a manner that meets customers' needs;

the Corporation's timely development of competitive new products and services in a changing environment and the acceptance of such products and services by customers;

the Corporation's ability to originate, sell and service residential mortgage loans;

the accuracy of assumptions underlying the establishment of reserves for loan losses and estimates in the value of collateral, the market value of mortgage servicing rights and various financial assets and liabilities;

the Corporation's ability to retain key members of the senior management team;

the ability of key third-party providers to perform their obligations to the Corporation and the Bank;

technological changes being more difficult or expensive than anticipated; and

the Corporation's success in managing the risks involved in the foregoing.

All written or oral forward-looking statements attributed to the Corporation and the Bank are expressly qualified in their entirety by use of the foregoing cautionary statements. All forward-looking statements included in this Quarterly Report and incorporated documents are based upon the Corporation's beliefs and assumptions as of the date of this Quarterly Report. The Corporation assumes no obligation to update any forward-looking statement. In light of these risks, uncertainties and assumptions, the forward-looking statements discussed in this Quarterly Report or incorporated documents might not occur and you should not put undue reliance on any forward-looking statements.

### **ITEM 3. Quantitative and Qualitative Disclosures About Market Risks**

See Item 2 Management's Discussion and Analysis of Results of Operations Interest Rate Summary, Summary of Interest Rate Simulation, and Gap Analysis for a discussion of the Corporation's and Bank's exposure to market risk since December 31, 2013. For further discussion of quantitative and qualitative disclosures about market risks, please also refer to the Corporation's 2013 Annual Report.

### **ITEM 4. Controls and Procedures**

As of the end of the period covered by this report, the Corporation carried out an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's Chief Executive Officer, Frederick C. Peters II, and Chief Financial Officer, J. Duncan Smith, of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures as defined in the Exchange Act Rules 13a-15(e) and 15d-15(e). Based upon the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Corporation's disclosure controls and procedures were effective as of June 30, 2014.

There have not been any changes in the Corporation's internal controls over financial reporting during the quarter ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.



**Table of Contents****PART II OTHER INFORMATION.****ITEM 1. Legal Proceedings.**

None.

**ITEM 1A. Risk Factors.**

In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the factors discussed in **Risk Factors** included within the 2013 Annual Report and subsequently filed Quarterly Reports on Form 10-Q. The risks described in the 2013 Annual Report are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results. See **Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations** **Special Cautionary Notice Regarding Forward Looking Statements.**

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds****Share Repurchase**

The following table presents the shares repurchased by the Corporation during the first quarter of 2014<sup>(1)</sup>:

| <b>Period</b>                  | <b>Total Number of Shares Purchased<sup>(2)(3)(4)</sup></b> | <b>Average Price Paid Per Share</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b> | <b>Maximum Number of Shares that May Yet Be Purchased Under the Plan or Programs</b> |
|--------------------------------|---|-------------------------------------|---|--|
| April 1, 2014 – April 30, 2014 | 3,283   | \$ 27.96                            |   | 195,705  |
| May 1, 2014 – May 31, 2014     | 1,767   | \$ 27.70                            |   | 195,705  |
| June 1, 2014 – June 30, 2014   |   | \$                                  |   | 195,705  |
| <b>Total</b>                   | <b>5,050</b>  | <b>\$ 27.87</b>                     |   | <b>195,705</b>   |

<sup>(1)</sup> On February 24, 2006, the Board of Directors of the Corporation adopted a stock repurchase program (the 2006 Program) under which the Corporation may repurchase up to 450,000 shares of the Corporation's common stock, not to exceed \$10 million. The 2006 Program was publicly announced in a Press Release dated February 24, 2006. There is no expiration date on the 2006 Program and the Corporation has no plans for an early termination of the 2006 Program. All shares purchased through the 2006 Program were accomplished in open market transactions. As of June 30, 2014, the maximum number of shares that may yet be purchased under

*the 2006 Program was 195,705.*

- (2) *On April 1, 2014, 1,401 shares were purchased by the Corporation's deferred compensation plans through open market transactions.*
- (3) *Between April 17, 2014 and April 22, 2014, the Corporation purchased 1,882 shares and retired them to treasury to satisfy statutory tax withholding requirements in connection with the exercise of stock option awards for certain of the Bank's officers.*
- (4) *On May 15, 2014, 1,767 shares were purchased and retired to treasury to satisfy statutory tax withholding requirements in connection with the vesting of restricted stock awards for certain of the Bank's officers.*

**ITEM 3. Defaults Upon Senior Securities**

**None.**

**ITEM 4. Mine Safety Disclosures.**

**Not applicable.**

**ITEM 5. Other Information**

**None.**

**Table of Contents****ITEM 6. Exhibits**

| <b>Exhibit No.</b> | <b>Description and References</b>  |
|--------------------|--|
| 2.1                | Agreement and Plan of Merger, dated as of May 5, 2014, by and between Bryn Mawr Bank Corporation and Continental Bank Holdings, Inc., incorporated by reference to Exhibit 2.1 to the Corporation's Form 8-K filed with the SEC on May 5, 2014 |
| 3.1                | Amended and Restated By-Laws, effective November 20, 2007, incorporated by reference to Exhibit 3.2 of the Corporation's Form 8-K filed with the SEC on November 21, 2007  |
| 3.2                | Amended and Restated Articles of Incorporation, effective November 21, 2007, incorporated by reference to Exhibit 3.1 of the Corporation's Form 8-K filed with the SEC on November 21, 2007  |
| 10.1*              | Employment Letter Agreement, dated as of April 25, 2014, between the Corporation and Francis J. Leto, incorporated by reference to Exhibit 10.1 to the Corporation's Form 8-K filed with the SEC on April 25, 2014                             |
| 31.1               | Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith   |
| 10.2               | Form of Director Letter Agreement, filed herewith  |
| 31.2               | Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith   |
| 32.1               | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith  |
| 32.2               | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith  |
| 101.INS XBRL       | Instance Document, furnished herewith  |
| 101.SCH XBRL       | Taxonomy Extension Schema Document, filed herewith   |
| 101.CAL XBRL       | Taxonomy Extension Calculation Linkbase Document, filed herewith   |
| 101.DEF XBRL       | Taxonomy Extension Definition Linkbase Document, filed herewith  |
| 101.LAB XBRL       | Taxonomy Extension Label Linkbase Document, filed herewith   |
| 101.PRE XBRL       | Taxonomy Extension Presentation Linkbase Document, filed herewith  |

\* Management contract or compensatory plan arrangement.

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Signatures

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

Bryn Mawr Bank Corporation

Date: August 8, 2014

By: */s/* FREDERICK C. PETERS II  
**Frederick C. Peters II**  
**Chief Executive Officer**

Date: August 8, 2014

By: */s/* J. DUNCAN SMITH  
**J. Duncan Smith**  
**Treasurer & Chief Financial Officer**

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**Table of Contents****Form 10-Q****Index to Exhibits Furnished Herewith**

| <b>Exhibit No.</b> | <b>Description and References</b>  |
|--------------------|--|
| 2.1                | Agreement and Plan of Merger, dated as of May 5, 2014, by and between Bryn Mawr Bank Corporation and Continental Bank Holdings, Inc., incorporated by reference to Exhibit 2.1 to the Corporation's Form 8-K filed with the SEC on May 5, 2014 |
| 3.1                | Amended and Restated By-Laws, effective November 20, 2007, incorporated by reference to Exhibit 3.2 of the Corporation's Form 8-K filed with the SEC on November 21, 2007  |
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