NEWMARKET CORP
Form 10-Q
October 27, 2009
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2009

OR

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

For the transition period from ______ to ______

Commission File Number 1-32190

NEWMARKET CORPORATION

(Exact name of registrant as specified in its charter)

VIRGINIA	**20-0812170**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
330 SOUTH FOURTH STREET RICHMOND, VIRGINIA	**23218-2189**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code - (804) 788-5000

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

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

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

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	¨

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

Number of shares of common stock, without par value, outstanding as of September 30, 2009: 15,207,989.

Table of Contents

NEWMARKET CORPORATION

I N D E X

	Page Number
PART I. FINANCIAL INFORMATION	
ITEM 1. Financial Statements (unaudited)	
Consolidated Statements of Income Third Quarter and Nine Months Ended September 30, 2009 and September 30, 2008	3
Consolidated Balance Sheets September 30, 2009 and December 31, 2008	4
Consolidated Statements of Cash Flows Nine Months Ended September 30, 2009 and September 30, 2008	5
Notes to Consolidated Financial Statements	6 - 33
ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	34 - 42
ITEM 3. Quantitative and Qualitative Disclosures About Market Risk	42
ITEM 4. Controls and Procedures	43
PART II. OTHER INFORMATION	
ITEM 1. Legal Proceedings	44
ITEM 1A. Risk Factors	44
ITEM 6. Exhibits	44 - 45
SIGNATURES	46

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. Financial Statements

NEWMARKET CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per-share amounts)

(Unaudited)

	Third Quarter Ended September 30		Nine Months Ended September 30	
	2009	**2008**	**2009**	**2008**
Net sales	$ 417,832	$ 440,604	$ 1,125,881	$ 1,248,836
Cost of goods sold	274,865	367,026	780,427	1,011,462
Gross profit	142,967	73,578	345,454	237,374
Selling, general, and administrative expenses	27,618	28,476	83,141	87,748
Research, development, and testing expenses	21,602	19,471	61,448	61,579
Operating profit	93,747	25,631	200,865	88,047
Interest and financing expenses	2,909	2,966	8,704	8,854
Other (expense) income, net	(3,804)	222	(15,734)	901
Income before income tax expense	87,034	22,887	176,427	80,094
Income tax expense	30,347	6,415	60,394	26,226
Net income	$ 56,687	$ 16,472	$ 116,033	$ 53,868
Basic earnings per share	$ 3.73	$ 1.08	$ 7.63	$ 3.49
Diluted earnings per share	$ 3.72	$ 1.07	$ 7.61	$ 3.48
Shares used to compute basic earnings per share	15,208	15,306	15,205	15,418
Shares used to compute diluted earnings per share	15,245	15,365	15,243	15,493
Cash dividends declared per common share	$ 0.25	$ 0.20	$ 0.70	$ 0.60

See accompanying notes to the consolidated financial statements.

Table of Contents

NEWMARKET CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

(Unaudited)

	September 30 2009	December 31 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 133,770	$ 21,761
Short-term investments	300	
Trade and other accounts receivable, less allowance for doubtful accounts ($1,141 in 2009 and 2008)	229,603	203,551
Inventories:		
Finished goods	144,371	158,325
Raw materials	30,582	34,657
Stores, supplies and other	7,504	8,090
	182,457	201,072
Deferred income taxes	27,677	14,090
Prepaid expenses and other current assets	9,141	5,704
Total current assets	582,948	446,178
Property, plant and equipment, at cost	922,941	848,011
Less accumulated depreciation and amortization	629,492	606,275
Net property, plant and equipment	293,449	241,736
Prepaid pension cost	36	159
Deferred income taxes	40,154	37,744
Other assets and deferred charges	41,283	31,566
Intangibles, net of amortization and goodwill	47,271	54,069
Total assets	$ 1,005,141	$ 811,452
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 100,447	$ 60,505
Accrued expenses	66,992	63,715
Dividends payable	3,319	2,646
Book overdraft	2,896	999
Long-term debt, current portion	86,055	784
Income taxes payable	22,341	7,264
Total current liabilities	282,050	135,913
Long-term debt	150,358	236,378
Other noncurrent liabilities	160,283	148,038

Commitments and contingencies (Note 8)		
Shareholders equity:		
Common stock and paid-in capital (without par value); authorized shares - 80,000,000; Outstanding shares - 15,207,989 in 2009 and 15,199,207 in 2008	266	115
Accumulated other comprehensive loss	(79,963)	(95,750)
Retained earnings	492,147	386,758
	412,450	291,123
Total liabilities and shareholders equity	$ 1,005,141	$ 811,452

See accompanying notes to the consolidated financial statements.

Table of Contents

NEWMARKET CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended September 30 2009	2008
Cash and cash equivalents at beginning of year	$ 21,761	$ 71,872
Cash flows from operating activities:		
Net income	116,033	53,868
Adjustments to reconcile net income to cash flows from operating activities:		
Depreciation and other amortization	23,485	20,449
Amortization of deferred financing costs	887	749
Noncash environmental remediation and dismantling	4,025	811
Noncash pension benefits expense	10,147	8,797
Noncash postretirement benefits expense	1,982	2,014
Noncash foreign exchange loss	551	3,978
Deferred income tax (benefit) expense	(19,491)	3,857
Unrealized loss (gain) on derivative instruments - net	15,884	(356)
Gain on legal settlement		(3,227)
Working capital changes	67,283	(69,908)
Excess tax benefits from stock-based payment arrangements		(900)
Cash pension benefits contributions	(17,308)	(10,996)
Cash postretirement benefits contributions	(1,005)	(1,423)
Proceeds from legal settlement		3,227
Other, net	(7,856)	623
Cash provided from operating activities	194,617	11,563
Cash flows from investing activities:		
Capital expenditures	(26,506)	(21,831)
Foundry Park I capital expenditures	(40,403)	(29,046)
Purchase of short-term investment	(300)	
Acquisition of business		(14,721)
Deposits for interest rate lock agreement	(5,000)	
Return of deposits for interest rate lock agreement	15,500	1,050
Return of deposits for interest rate swap	9,930	
Deposits for interest rate swap	(29,900)	
Cash used in investing activities	(76,679)	(64,548)
Cash flows from financing activities:		
Draws on Foundry Park I construction loan	41,735	25,083
Net (repayments) borrowings under revolving credit agreement	(41,900)	31,800
Repurchases of common stock		(26,810)
Dividends	(10,644)	(12,090)
Change in book overdraft, net	1,897	(1,637)
Payment for financed intangible asset	(750)	(750)
Debt issuance costs	(412)	

Proceeds from exercise of stock options	31	246
Excess tax benefits from stock-based payment arrangements		900
Payments on the capital lease	(584)	(548)
Cash (used in) provided from financing activities	(10,627)	16,194
Effect of foreign exchange on cash and cash equivalents	4,698	(1,590)
Increase (decrease) in cash and cash equivalents	112,009	(38,381)
Cash and cash equivalents at end of period	$ 133,770	$ 33,491

See accompanying notes to the consolidated financial statements.

Table of Contents

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Financial Statement Presentation

In the opinion of management, the accompanying consolidated financial statements of NewMarket Corporation and its subsidiaries contain all necessary adjustments for the fair presentation of, in all material respects, our consolidated financial position as of September 30, 2009, as well as our consolidated results of operations for the third quarter and nine months ended September 30, 2009 and September 30, 2008 and our consolidated cash flows for the nine months ended September 30, 2009 and September 30, 2008. All adjustments are of a normal, recurring nature, unless otherwise disclosed. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the NewMarket Corporation Annual Report on Form 10-K for the fiscal year ended December 31, 2008 (2008 Annual Report), as filed with the Securities and Exchange Commission (SEC). The results of operations for the nine month period ended September 30, 2009 are not necessarily indicative of the results to be expected for the full year ending December 31, 2009. The December 31, 2008 consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Unless the context otherwise requires, all references to we, us, our, the Company and NewMarket are to NewMarket Corporation and its consolidated subsidiaries.

Certain amounts in the accompanying financial statements have been reclassified to conform to the current presentation. There was no effect on net income.

At both September 30, 2009 and December 31, 2008, we had a book overdraft for some of our disbursement cash accounts. A book overdraft represents transactions that have not cleared the bank accounts at the end of the reporting period. There are no agreements with the same banks to offset the presented balance. We transfer cash on an as-needed basis to fund these items as they clear the bank in subsequent periods.

Cash dividends totaling 70 cents per share for the nine months ended September 30, 2009 and 60 cents per share for the nine months ended September 30, 2008 were declared and paid as shown in the table below.

Year	Date Declared	Date Paid	Per Share Amount
2009	February 19, 2009	April 1, 2009	20 cents
	April 23, 2009	July 1, 2009	25 cents
	July 30, 2009	October 1, 2009	25 cents
2008	February 28, 2008	April 1, 2008	20 cents
	April 24, 2008	July 1, 2008	20 cents
	July 31, 2008	October 1, 2008	20 cents

Table of Contents

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

During the nine months ended September 30, 2009, we had noncash investing activity of $5.8 million related to capital expenditures incurred, but not paid, for the construction of the office building by Foundry Park I, LLC (Foundry Park I).

2. Asset Retirement Obligations

The following table illustrates the activity associated with our asset retirement obligations for the nine months ended September 30, 2009 and September 30, 2008.

	2009	2008
	(in thousands)	
Asset retirement obligations, January 1	$ 3,009	$ 5,048
Liabilities incurred	2,000	
Accretion expense	135	220
Liabilities settled	(1,539)	(1,070)
Changes in expected cash flows and timing	(526)	(417)
Foreign currency impact		(8)
Asset retirement obligations, September 30	$ 3,079	$ 3,773

3. Segment Information

The tables below show our consolidated segment net sales, operating profit (including a reconciliation of segment operating profit to income before income taxes), and depreciation and amortization.

The All other category includes the continuing operations of the tetraethyl lead (TEL) business (primarily sales of TEL in North America), certain contract manufacturing Ethyl Corporation (Ethyl) provides to Afton Chemical Corporation (Afton) and to third parties, as well as the real estate development activities.

The real estate development operating segment represents the construction of the office building by Foundry Park I. Total segment assets of the real estate development operating segment amounted to $104.0 million at September 30, 2009 and $62.9 million at December 31, 2008. Additions to long-lived assets for the real estate development operating segment were $41.1 million for nine months 2009. Since its inception, there has been no sales revenue and an insignificant operating loss of the real estate development operating segment, as the building has been under construction. We expect to begin recognizing rental revenue beginning in 2010.

Table of Contents

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Segment Net Sales

(in millions)

	Third Quarter Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Petroleum additives	$ 413.7	$ 437.2	$ 1,116.7	$ 1,238.8
All other	4.1	3.4	9.2	10.0
Consolidated net sales	$ 417.8	$ 440.6	$ 1,125.9	$ 1,248.8

Segment Operating Profit

(in millions)

	Third Quarter Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Petroleum additives (a)	$ 96.3	$ 28.1	$ 214.0	$ 97.5
All other	1.0	0.5	(1.3)	1.0
Segment operating profit	97.3	28.6	212.7	98.5
Corporate, general, and administrative expenses	(3.3)	(3.3)	(12.1)	(10.9)
Interest and financing expenses	(2.9)	(3.0)	(8.7)	(8.9)
Unrealized loss on interest rate swap agreement (b)	(3.8)		(15.7)	
Other (expense) income, net	(0.3)	0.6	0.2	1.4
Income before income taxes	$ 87.0	$ 22.9	$ 176.4	$ 80.1

(a) Petroleum additives segment operating profit for nine months 2008 includes a gain of $3.2 million from a class action lawsuit related to raw materials.

(b) The unrealized loss on the interest rate swap agreement represents the change, since the beginning of the reporting period, in the fair value of an interest rate swap which we entered into on June 25, 2009. We are not using hedge accounting to record the interest rate swap, and accordingly, any change in the fair value is immediately recognized in earnings.

Table of Contents

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Segment Depreciation and Amortization

(in millions)

	Third Quarter Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Petroleum additives	$ 7.6	$ 6.4	$ 22.4	$ 19.3
All other		0.1	0.1	0.1
Corporate	0.6	0.6	1.9	1.8
Total depreciation and amortization	$ 8.2	$ 7.1	$ 24.4	$ 21.2

4. Pension and Postretirement Benefit Plans

During the nine months ended September 30, 2009, we made cash contributions of approximately $10.8 million for domestic pension plans and approximately $900 thousand for domestic postretirement benefit plans. We expect to make total cash contributions in 2009 of approximately $15 million for our domestic pension plans and approximately $1 million for our domestic postretirement benefit plans.

We made cash contributions of approximately $6.5 million for our foreign pension plans and approximately $100 thousand for a foreign postretirement benefit plan during the nine months ended September 30, 2009. During 2009, we expect to make total cash contributions of approximately $8 million for our foreign pension plans and approximately $150 thousand for our foreign postretirement benefit plan.

Table of Contents

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The tables below present information on periodic benefit cost for our pension and postretirement benefit plans.

	Domestic			
	Pension Benefits		Postretirement Benefits	
	Third Quarter Ended September 30			
	2009	2008	2009	2008
	(in thousands)			
Service cost	$ 1,493	$ 1,420	$ 260	$ 191
Interest cost	2,041	1,938	806	716
Expected return on plan assets	(2,301)	(1,931)	(388)	(413)
Amortization of prior service cost	72	73	1	2
Amortization of net loss (gain)	672	559	(169)	(300)
	$ 1,977	$ 2,059	$ 510	$ 196

	Domestic			
	Pension Benefits		Postretirement Benefits	
	Nine Months Ended September 30			
	2009	2008	2009	2008
	(in thousands)			
Service cost	$ 4,290	$ 3,986	$ 814	$ 758
Interest cost	5,951	5,622	2,556	2,619
Expected return on plan assets	(6,444)	(5,839)	(1,226)	(1,244)
Amortization of prior service cost	217	219	6	8
Amortization of net loss (gain)	1,927	1,415	(340)	(313)
	$ 5,941	$ 5,403	$ 1,810	$ 1,828

Table of Contents

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

	Foreign Pension Benefits		Postretirement Benefits	
	Third Quarter Ended September 30			
	2009	2008	2009	2008
	(in thousands)			
Service cost	$ 673	$ 741	$ 3	$ 5
Interest cost	1,321	1,469	37	32
Expected return on plan assets	(1,024)	(1,450)		
Amortization of prior service cost	19	20		
Amortization of transition asset	(9)	(9)	12	12
Amortization of net loss	434	350	9	11
	$ 1,414	$ 1,121	$ 61	$ 60

	Foreign Pension Benefits		Postretirement Benefits	
	Nine Months Ended September 30			
	2009	2008	2009	2008
	(in thousands)			
Service cost	$ 1,904	$ 2,251	$ 9	$ 14
Interest cost	3,732	4,469	104	100
Expected return on plan assets	(2,880)	(4,423)		
Amortization of prior service cost	53	62		
Amortization of transition asset	(25)	(29)	34	39
Amortization of net loss	1,224	1,064	25	33
Settlement loss	198			
	$ 4,206	$ 3,394	$ 172	$ 186

The settlement loss for the nine months ended September 30, 2009 represents the termination of a pension plan of our Ethyl subsidiary in Belgium.

Table of Contents

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

5. Earnings Per Share

Basic and diluted earnings per share are calculated as shown in the table below. Options are not included in the computation of diluted earnings per share when the option exercise price exceeds the average market price of the underlying common share, as the impact on earnings per share would be anti-dilutive. We had no anti-dilutive options that were excluded from the calculation of earnings per share for any period presented.

	Third Quarter Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
	(in thousands, except per-share amounts)			
Basic earnings per share				
Numerator:				
Net income	$ 56,687	$ 16,472	$ 116,033	$ 53,868
Denominator:				
Weighted-average number of shares of common stock outstanding	15,208	15,306	15,205	15,418
Basic earnings per share	$ 3.73	$ 1.08	$ 7.63	$ 3.49
Diluted earnings per share				
Numerator:				
Net income	$ 56,687	$ 16,472	$ 116,033	$ 53,868
Denominator:				
Weighted-average number of shares of common stock outstanding	15,208	15,306	15,205	15,418
Shares issuable upon exercise of stock options	37	59	38	75
Total shares	15,245	15,365	15,243	15,493
Diluted earnings per share	$ 3.72	$ 1.07	$ 7.61	$ 3.48

Table of Contents

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

6. Intangibles, net of amortization

The following table provides certain information related to our intangible assets. All of the intangibles relate to the petroleum additives segment.

	Identifiable Intangibles			
	September 30 2009		December 31 2008	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(in thousands)			
Amortizing intangible assets				
Formulas	$ 88,687	$ 57,430	$ 88,687	$ 53,476
Contracts	16,380	6,150	16,380	3,687
Customer base	5,440	517	5,440	136
Goodwill	861		861	
	$ 111,368	$ 64,097	$ 111,368	$ 57,299

Amortization expense for the third quarter and nine month periods was (in millions):

Third quarter ended September 30, 2009	$ 2.2
Nine months ended September 30, 2009	$ 6.8
Third quarter ended September 30, 2008	$ 1.5
Nine months ended September 30, 2008	$ 4.6

Estimated annual amortization expense related to our intangible assets for the next five years is expected to be (in millions):

2009	$ 8.9
2010	$ 8.3
2011	$ 8.0
2012	$ 6.9
2013	$ 6.6

We amortize the cost of the customer base intangible by an accelerated method and the cost of the remaining intangible assets by the straight-line method over their estimated economic lives. We generally amortize contracts over 1.5 to 10 years and formulas, as well as the customer base, over 20 years.

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

7. Long-term Debt

Long-term debt consisted of the following:

	September 30 2009	December 31 2008
	(in thousands)	
Senior notes - 7.125% due 2016	$ 150,000	$ 150,000
Foundry Park I construction loan - due 2010	85,234	43,499
Revolving credit facility - due 2011		41,900
Capital lease obligations	1,179	1,763
	236,413	237,162
Current maturities of long-term debt	(86,055)	(784)
	$ 150,358	$ 236,378

On January 5, 2009, we entered into a Supplement Agreement to the Second Amended and Restated Revolving Credit Agreement to increase the commitment level of the revolving credit facility by $5 million. Subsequently, on March 24, 2009, we entered into a Second Amendment to the Second Amended and Restated Revolving Credit Agreement (Second Amendment). The Second Amendment increased the commitment level by an additional $5 million, increased the letter of credit commitment level from $50 million to $75 million, increased the interest rate paid for borrowings, and amended certain defined terms and covenant calculations. On March 24, 2009, we entered into a Supplement Agreement to the Second Amended and Restated Revolving Credit Agreement to increase the commitment level of the revolving credit facility by $2.25 million. On April 20, 2009, we entered into an agreement to add an additional lender under our revolving credit facility and increase the commitment level by $10 million. Subsequently, on June 30, 2009, that lender increased its commitment level by another $10 million.

All of these transactions resulted in a commitment level of $139.25 million at September 30, 2009. We paid financing costs of $400 thousand related to these transactions, which will be amortized over the remaining term of the revolving credit facility. We had outstanding letters of credit of $4.6 million at September 30, 2009, resulting in the unused portion of the revolving credit facility amounting to $134.7 million.

8. Contractual Commitments and Contingencies

Except as discussed below, there have been no significant changes in our contractual commitments and contingencies from those reported in our 2008 Annual Report in Note 17 of the Notes to Consolidated Financial Statements.

Litigation

We are involved in legal proceedings that are incidental to our business and include administrative or judicial actions seeking remediation under environmental laws, such as Superfund. Some of these legal proceedings relate to environmental matters and involve governmental authorities. For further information, see Environmental below.

While it is not possible to predict or determine with certainty the outcome of any legal proceeding, we believe the outcome of any of these proceedings, or all of them combined, will not result in a material adverse effect on our consolidated financial condition or results of operations.

14

Table of Contents

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Environmental

During 2000, the U.S. Environmental Protection Agency (EPA) named us as a potentially responsible party (PRP) under Superfund law for the clean-up of soil and groundwater contamination at the Sauget Area 2 Site in Sauget, Illinois. Without admitting any fact, responsibility, fault, or liability in connection with this site, we are participating with other PRPs in site investigations and feasibility studies.

The Sauget Area 2 Site PRPs are currently working with the EPA to submit an acceptable Remedial Investigation and Feasibility Study (RI/FS) to the EPA, which we expect to occur in late 2009. We have accrued our estimated proportional share of the expenses for the RI/FS, as well as our best estimate of our proportional share of the remediation liability proposed in our ongoing discussions and submissions with the agencies involved. The amount currently accrued for this site is not material.

At a former TEL plant site located in Louisiana, we have completed significant environmental remediation, although we will be monitoring and treating the site for an extended period. The accrual for this site was $7.6 million at September 30, 2009 and $8.8 million at December 31, 2008. We based these amounts on the best estimate of future costs discounted at approximately 3% in 2009 and 2% in 2008. An inflation factor is included in the estimate. The undiscounted liability was $10.1 million at September 30, 2009 and $9.6 million at December 31, 2008. The expected payments over the next five years amount to approximately $800 thousand in 2010 and $600 thousand for each of the years 2011 through 2014. Expected payments thereafter amount to approximately $7 million.

At a plant site in Houston, Texas, we have accruals of $8.0 million at September 30, 2009 and $6.7 million at December 31, 2008 for environmental remediation, dismantling, and decontamination. Included in these amounts are $7.7 million at September 30, 2009 and $5.8 million at December 31, 2008 for remediation. The increase in the accruals between 2008 and 2009 primarily relate to additional costs expected to be incurred for the closure of a landfill on the plant site. The accruals for this site are discounted at approximately 3% at September 30, 2009 and approximately 4% at December 31, 2008 for a portion of the site. The accruals include an inflation factor. The undiscounted accrual for this site was $11.3 million at September 30, 2009 and $7.8 million at December 31, 2008. The expected payments over the next five years are approximately $500 thousand in 2010, $800 thousand in 2011, $2.6 million in 2012, and $200 thousand for each of 2013 and 2014. Expected payments thereafter amount to approximately $6.8 million.

At a superfund site in Louisiana, we have an accrual of $2.8 million at September 30, 2009 and $3.3 million at December 31, 2008 for environmental remediation. The accrual for this site was discounted at approximately 3% and included an inflation factor. The undiscounted accrual for this site was $3.4 million at September 30, 2009 and $3.3 million at December 31, 2008. The expected payments over the next five years amount to approximately $600 thousand in 2010 and $200 thousand each for years 2011 through 2014. Expected payments thereafter amount to approximately $2.0 million.

The remaining environmental liabilities are not discounted.

We accrue for environmental remediation and monitoring activities for which costs can be reasonably estimated and are probable. These estimates are based on an assessment of the site, available clean-up methods, and prior experience in handling remediation. While we believe we are currently fully accrued for known environmental issues, it is possible that unexpected future costs could have a significant impact on our financial position and results of operations.

Table of Contents

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Our total accruals for environmental remediation were approximately $22.3 million at September 30, 2009 and $20.6 million at December 31, 2008. In addition to the accruals for environmental remediation, we also have accruals for dismantling and decommissioning costs of $500 thousand at September 30, 2009 and $1.3 million at December 31, 2008.

Letters of Credit and Guarantees

We have outstanding guarantees with several financial institutions in the amount of $27.8 million at September 30, 2009. The guarantees are secured by letters of credit, as well as cash collateral. The outstanding letters of credit amounted to $4.6 million at September 30, 2009, all of which were issued under the letter of credit sub-facility of our revolving credit facility. See Note 7 in the Notes to Consolidated Financial Statements. The letters of credit primarily relate to insurance guarantees. We renew letters of credit as necessary. The remaining amounts represent performance, lease, custom and excise tax guarantees, as well as a cash deposit of $20.0 million related to the Goldman Sachs Bank USA (Goldman Sachs) interest rate swap. The cash deposit is recorded in Other assets and deferred charges on the Consolidated Balance Sheet. See Note 9 in the Notes to Consolidated Financial Statements. Expiration dates range from 2009 to 2012. Some of the guarantees have no expiration date.

We cannot estimate the maximum amount of potential liability under the guarantees. However, we accrue for potential liabilities when a future payment is probable and the range of loss can be reasonably estimated.

Interest Rate Lock Agreement

The construction loan for the Foundry Park I project to construct an office building for MeadWestvaco is being financed by a group of banks and matures in August 2010. Prior to commencing construction, we took actions to identify the possible permanent lending source after construction. To that end, Foundry Park I entered into an Application with Principal Commercial Funding II, LLC (Principal) dated February 26, 2007, which outlined the terms and conditions under which Principal would provide permanent, fixed-rate financing in the maximum amount of $116,000,000 amortized over 25 years with all amounts due 13.5 years after the date of the loan. The Application was not a loan commitment due to the lengthy time period of thirty-four months until the completion of the building. In order to obtain a fixed-rate loan, we entered into a rate lock agreement with Principal dated February 26, 2007. Principal simultaneously entered into a hedge with a third party based mainly on the forward rates of ten-year Treasuries. We were not a party to that hedging agreement. Under the rate lock agreement, we agreed to post a deposit with Principal and to increase the amount of that deposit if the exposure to Principal on their hedge increased.

In June 2009, Principal and Foundry Park I determined that the loan terms set forth in the Application could not be syndicated based on current market conditions. As a result, Principal and Foundry Park I terminated the loan application and related rate lock agreement and mutually released each other from their respective rights and obligations under those arrangements. While we are currently investigating alternative financing to replace the Foundry Park I project construction loan when it matures and believe that we can obtain financing on acceptable terms, we cannot predict the financing terms which will be available at that time. See Note 9 in the Notes to Consolidated Financial Statements for additional information on the termination of the rate lock agreement and subsequent entry into an interest rate swap with Goldman Sachs related to the Foundry Park I project. All amounts which we had deposited with Principal under the rate lock agreement have effectively been returned to us at the termination of the rate lock agreement as Principal transferred the deposited funds to Goldman Sachs as collateral for the interest rate swap related to the Foundry Park I project.

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

9. Derivatives and Hedging Activities

Accounting Policy for Derivative Instruments and Hedging Activities

We record all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether we have elected to designate a derivative in a hedging relationship and apply hedge accounting, and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Derivatives may also be designated as hedges of the foreign currency exposure of a net investment in a foreign operation. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. We may enter into derivative contracts that are intended to economically hedge certain of our risk, even though hedge accounting does not apply or we elect not to apply hedge accounting. We do not enter into derivative instruments for speculative purposes.

Risk Management Objective of Using Derivatives

We are exposed to certain risks arising from both our business operations and economic conditions. We primarily manage our exposures to a wide variety of business and operational risks through management of our core business activities.

We manage certain economic risks, including interest rate, liquidity, and credit risk primarily by managing the amount, sources, and duration of our debt funding, as well as through the use of derivative financial instruments. Specifically, we have entered into interest rate swaps to manage our exposure to interest rate movements.

Our foreign operations expose us to fluctuations of foreign exchange rates. These fluctuations may impact the value of our cash receipts and payments as compared to our reporting currency, the U.S. Dollar. To manage this exposure, we sometimes enter into foreign currency forward contracts to minimize currency exposure due to cash flows from foreign operations.

Cash Flow Hedge of Interest Rate Risk

We have entered into an interest rate swap to manage our exposure to interest rate movements on the Foundry Park I construction loan and add stability to capitalized interest expense. Further information on the construction loan is in our 2008 Annual Report in Note 12 of the Notes to Consolidated Financial Statements. The interest rate swap related to the Foundry Park I construction loan is designated and qualifies as a cash flow hedge. As such, the effective portion of changes in the fair value of the swap is recorded in accumulated other comprehensive loss and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The ineffective portion of changes in the fair value of the swap is recognized immediately in earnings. We assess the effectiveness of the construction loan interest rate swap quarterly by comparing the changes in the fair value of the derivative hedging instrument with the change in present value of the expected future cash flows of the hedged transaction.

Table of Contents

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The construction loan interest rate swap involves the receipt of variable-rate amounts based on LIBOR in exchange for fixed-rate payments over the life of the agreement without exchange of the underlying notional amount. The fixed-rate payments are at a rate of 4.975%. The notional amount of the construction loan interest rate swap was approximately $84.0 million at September 30, 2009 and $52.9 million at December 31, 2008 and accretes to approximately $94.0 million over the term of the swap. The accreting notional amount is necessary to maintain the swap notional at an amount that represents approximately 85% of the projected construction loan principal balance over the loan term. The maturity date of the construction loan interest rate swap is January 1, 2010.

The unrealized loss, net of tax, related to the fair value of the construction loan interest rate swap and recorded in accumulated other comprehensive loss in shareholders equity on the Consolidated Balance Sheets, amounted to approximately $700 thousand at September 30, 2009 and $1.9 million at December 31, 2008. Also recorded as a component of accumulated other comprehensive loss in shareholders equity on the Consolidated Balance Sheets was the net amount of swap receipts and payments made since the inception of the construction loan interest rate swap. This amounted to approximately $2.0 million, net of tax, at September 30, 2009 and $400 thousand, net of tax, at December 31, 2008. Any amounts remaining in accumulated other comprehensive loss related to the construction loan interest rate swap will be recognized in the Consolidated Statements of Income over the depreciable life of the office building beginning at the completion of the construction project, which is currently expected to be late 2009. Approximately $80 thousand currently recognized in accumulated other comprehensive loss is expected to be reclassified into earnings over the next twelve months.

Non-designated Hedges

On June 25, 2009, we entered into an interest rate swap with Goldman Sachs in the notional amount of $97 million and with a maturity date of January 19, 2022 (Goldman Sachs interest rate swap). NewMarket entered into the Goldman Sachs interest rate swap in connection with the termination of a loan application and related rate lock agreement between Foundry Park I and Principal. See Note 8 above for further information on the transaction between Foundry Park I and Principal. When the rate lock agreement was originally executed in 2007, Principal simultaneously entered into an interest rate swap with a third party to hedge Principal s exposure to fluctuation in the ten-year Treasuries rate. Upon the termination on June 25, 2009 of the rate lock agreement, Goldman Sachs both assumed Principal s position with the third party and entered into an offsetting interest rate swap with NewMarket. Under the terms of this interest rate swap, NewMarket will make fixed rate payments at 5.3075% and Goldman Sachs will make variable rate payments based on three month LIBOR. We have collateralized this exposure through cash deposits posted with Goldman Sachs amounting to $20.0 million at September 30, 2009. This transaction effectively preserves the impact of the original rate lock agreement for the possible application to a future loan amount of $97 million of a similar structure.

In December 2008, we entered into $16.8 million of Euro-denominated forward contracts to minimize foreign currency exposure from expected cash flows from foreign operations. The forward contracts obligate us to sell Euros for U.S. Dollars at a fixed exchange rate of 1.403, which was agreed to at the inception of the contracts. These contracts have maturity dates through December 2009. The outstanding Euro-denominated foreign currency forward contracts amounted to $4.2 million at September 30, 2009 and $16.8 million at December 31, 2008. Any foreign currency rate change that affects the fair value of any of these forward contract transactions is offset by a corresponding change in the value of the Euro-denominated transactions.

Table of Contents

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

We elected not to use hedge accounting for both the Goldman Sachs interest rate swap and the forward contracts, and therefore, immediately recognize any change in the fair value of these derivative financial instruments directly in earnings.

*****

The table below presents the fair value of our derivative financial instruments, as well as their classification on the Consolidated Balance Sheets as of September 30, 2009 and December 31, 2008.

Fair Value of Derivative Instruments

(in thousands)

	Asset Derivatives				Liability Derivatives			
	September 30, 2009		December 31, 2008		September 30, 2009		December 31, 2008	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives Designated as Hedging Instruments								
Construction loan interest rate swap		$		$	Accrued expenses	$ 1,459	Accrued expenses	$ 3,231
Derivatives Not Designated as Hedging Instruments								
Goldman Sachs interest rate swap		$		$	Other long-term liabilities	$ 15,748		$
Foreign currency forward contracts		$	Trade and other accounts receivable	$ 164	Accrued expenses	$ 181		$

The tables below present the effect of our derivative financial instruments on the Consolidated Statements of Income.

Table of Contents

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Effect of Derivative Instruments on the Consolidated Statements of Income

Designated Cash Flow Hedges

(in thousands)

Derivatives in Cash Flow Hedging Relationship	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)		Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		Location of Gain (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	
	Third Quarter Ended September 30			Third Quarter Ended September 30			Third Quarter Ended September 30	
	2009	2008		2009	2008		2009	2008
Construction loan interest rate swap	$ (164)	$ (248)		$	$	Other (expense) income, net	$ 72	$ 41
	Nine Months Ended September 30			Nine Months Ended September 30			Nine Months Ended September 30	
	2009	2008		2009	2008		2009	2008
Construction loan interest rate swap	$ (528)	$ (389)		$	$	Other (expense) income, net	$ 45	$ (62)

Not Designated Derivatives

(in thousands)

Derivatives Not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income on Derivative	Amount of Gain (Loss) Recognized in Income on Derivative			
		Third Quarter Ended September 30		Nine Months Ended September 30	
		2009	2008	2009	2008
Goldman Sachs interest rate swap	Other (expense) income, net	$ (3,817)	$	$ (15,748)	$

Foreign currency forward contracts	Cost of goods sold	$	(183)	$	$	(346)	$

Credit-risk-related Contingent Features

We have an agreement with one of our derivative counterparties that contains a provision which specifies that if we default on any of our indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then we could be declared in default on our derivative obligations. We also have a separate agreement with another one of our derivative counterparties that contains a provision where we could be declared in default on our derivative obligations if repayment of the underlying indebtedness is accelerated by the lender due to our default on the indebtedness.

Table of Contents

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

As of September 30, 2009, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was $16.5 million. We have minimum collateral posting thresholds with one of our derivative counterparties and have posted cash collateral of $20.0 million as of September 30, 2009. If required, we could have settled our obligations under the agreements at their termination value of $16.5 million at September 30, 2009.

10. Comprehensive Income and Accumulated Other Comprehensive Loss

The components of comprehensive income consist of the following:

	Third Quarter Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
	(in thousands)			
Net income	$ 56,687	$ 16,472	$ 116,033	$ 53,868
Other comprehensive income, net of tax				
Pension plans and other postretirement benefits adjustments	278	2,352	1,826	3,533
Unrealized loss on derivative instruments	(102)	(155)	(329)	(243)
Foreign currency translation adjustments	(404)	(11,632)	14,290	(8,100)
Other comprehensive income	(228)	(9,435)	15,787	(4,810)
Comprehensive income	$ 56,459	$ 7,037	$ 131,820	$ 49,058

The components of accumulated other comprehensive loss consist of the following:

	September 30 2009	December 31 2008
	(in thousands)	
Pension plans and other postretirement benefit adjustments	$ (61,742)	$ (63,568)
Accumulated loss on derivative instruments	(2,630)	(2,301)
Foreign currency translation adjustments	(15,591)	(29,881)
Accumulated other comprehensive loss	$ (79,963)	$ (95,750)

11. Fair Value Measurements

The following table provides information on assets and liabilities measured at fair value on a recurring basis. No events occurred during the nine months ended September 30, 2009, requiring adjustment to the recognized balances of assets or liabilities which are recorded at fair value on a nonrecurring basis.

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

	Carrying Amount in Consolidated Balance Sheets	Fair Value	Fair Value Measurements Using Level 1	Level 2	Level 3
			September 30, 2009		
Cash and cash equivalents	$ 133,770	$ 133,770	$ 133,770	$	$
Short-term investments	$ 300	$ 300	$ 300	$	$
Foreign currency forward contracts liability	$ (180,538)	$ (180,538)	$	$ (180,538)	$
Interest rate swaps liability	$ 17,206	$ 17,206	$	$ 17,206	$
			December 31, 2008		
Cash and cash equivalents	$ 21,761	$ 21,761	$ 21,761	$	$
Foreign currency forward contracts asset	$ 164	$ 164	$	$ 164	$
Interest rate swap liability	$ 3,231	$ 3,231	$	$ 3,231	$

We determine the fair value of the derivative instruments shown in the table above by using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each instrument. The analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs.

The fair value of the interest rate swaps is determined using the market standard methodology of netting the discounted future fixed cash receipts and the discounted expected variable cash payments. The variable cash payments are based on an expectation of future interest rates derived from observable market interest rate curves. The fair value of the foreign currency forward contracts is based on interest differentials between the geographical areas and market forward points. In determining the fair value measurements, we incorporate credit valuation adjustments to appropriately reflect both our nonperformance risk and the counterparties nonperformance risk.

Although we have determined that the majority of the inputs used to value our derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustment associated with the derivatives utilizes Level 3 inputs. These Level 3 inputs include estimates of current credit spreads to evaluate the likelihood of default by both us and the counterparties to the derivatives. As of September 30, 2009, we have assessed the significance of the impact of the credit valuation adjustment on the overall valuation of our derivatives and have determined that the credit valuation adjustment is not significant to the overall valuation of the derivatives. Accordingly, we have determined that our derivative valuations should be classified in Level 2 of the fair value hierarchy.

We record the value of our long-term debt at historical cost. The estimated fair value of our long-term debt is shown in the table below and is based primarily on estimated current rates available to us for debt of the same remaining duration and adjusted for nonperformance risk and credit risk.

	September 30, 2009 Carrying Amount	Fair Value	December 31, 2008 Carrying Amount	Fair Value
Long-term debt, including current maturities	$ (236,413)	$ (229,491)	$ (237,162)	$ (199,315)

Table of Contents

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

12. Recently Issued Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2009-13, Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force (ASU 2009-13). ASU 2009-13 amends the criteria for revenue recognition of multi-deliverable arrangements and expands the required disclosures of those arrangements. ASU 2009-13 is effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. We are evaluating any potential impact on our financial statements.

In September 2009, the FASB issued Accounting Standard Update 2009-12, Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent) (ASU 2009-12). ASU 2009-12 clarifies the use of net asset value in determining fair value of an investment and requires certain disclosures pertaining to those investments. ASU 2009-12 is effective for interim and annual periods ending after December 31, 2009. We are evaluating any potential impact on our financial statements.

In August 2009, the FASB issued Accounting Standards Update 2009-05, Fair Value Measurements and Disclosures (Topic 820) Measuring Liabilities at Fair Value (ASU 2009-05). ASU 2009-05 provides clarification in measuring the fair value of a liability. ASU 2009-05 is effective beginning October 1, 2009. We currently do not expect ASU 2009-05 to have a significant impact on our financial statements

In June 2009, the FASB issued Financial Accounting Standard No. 167, Amendments to FASB Interpretation No. 46(R) (FAS 167). FAS 167 clarifies and improves financial reporting by entities involved with variable interest entities. FAS 167 is effective as of the beginning of the annual period beginning after November 15, 2009. We currently do not expect FAS 167 to have a significant impact on our financial statements.

In June 2009, the FASB issued Financial Accounting Standard No. 166, Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140 (FAS 166). FAS 166 clarifies the information that an entity must provide in its financial statements surrounding a transfer of financial assets and the effect of the transfer on its financial position, financial performance, and cash flows. FAS 166 is effective as of the beginning of the annual period beginning after November 15, 2009. We currently do not expect FAS 166 to have a significant impact on our financial statements.

13. Consolidating Financial Information

The 7.125% senior notes due 2016 are fully and unconditionally guaranteed by certain of our subsidiaries (Guarantor Subsidiaries) on a joint and several unsecured senior basis. The Guarantor Subsidiaries include all of our existing and future wholly-owned domestic restricted subsidiaries. The Guarantor Subsidiaries and the subsidiaries that do not guarantee the senior notes (the Non-Guarantor Subsidiaries) are wholly-owned by NewMarket Corporation (the Parent Company). The Guarantor Subsidiaries consist of the following:

Ethyl Corporation	Afton Chemical Corporation
Ethyl Asia Pacific LLC	Afton Chemical Asia Pacific LLC
Ethyl Canada Holdings, Inc.	Afton Chemical Canada Holdings, Inc.
Ethyl Export Corporation	Afton Chemical Japan Holdings, Inc.
Ethyl Interamerica Corporation	Afton Chemical Additives Corporation
Ethyl Ventures, Inc.	Afton Chemical Intangibles LLC
Interamerica Terminals Corporation	The Edwin Cooper Corporation
NewMarket Development Corporation	NewMarket Investment Company
NewMarket Services Corporation	Old Town LLC
Foundry Park I, LLC	Foundry Park II, LLC
Gamble s Hill, LLC	Gamble s Hill Lab, LLC

Gamble s Hill Landing, LLC	Gamble s Hill Third Street, LLC
Gamble s Hill Tredegar, LLC	

Table of Contents

NEWMARKET CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

We conduct all of our business and derive essentially all of our income from our subsidiaries. Therefore, our ability to make payments on the senior notes or other obligations is dependent on the earnings and the distribution of funds from our subsidiaries. There are no restrictions on the ability of any of our domestic subsidiaries to transfer funds to the Parent Company.

The following sets forth the Consolidating Statements of Income for the third quarter and nine months ended September 30, 2009 and September 30, 2008, Consolidating Balance Sheets as of September 30, 2009 and December 31, 2008, and Condensed Consolidating Statements of Cash Flows for the nine months ended September 30, 2009 and September 30, 2008 for the Parent Company, the Guarantor Subsidiaries, and Non-Guarantor Subsidiaries. The financial information is based on our understanding of the SEC s interpretation and application of Rule 3-10 of the SEC Regulation S-X.

The financial information may not necessarily be indicative of their results of operations or financial positions had the Guarantor Subsidiaries or Non-Guarantor Subsidiaries operated as independent entities. The Parent Company accounts for investments in these subsidiaries using the equity method.

Table of Contents

NewMarket Corporation and Subsidiaries

Consolidating Statements of Income

Third Quarter Ended September 30, 2009

(in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
Net sales	$	$ 231,097	$ 186,735	$	$ 417,832
Cost of goods sold		66,170	208,695		274,865
Gross profit (loss)		164,927	(21,960)		142,967
Selling, general, and administrative expenses	1,121	22,646	3,851		27,618
Research, development, and testing expenses		16,662	4,940		21,602
Operating (loss) profit	(1,121)	125,619	(30,751)		93,747
Interest and financing expenses (income)	3,005	(163)	67		2,909
Other (expense) income, net	(3,842)	68	(30)		(3,804)
(Loss) income before income tax (benefit) expense and equity income of subsidiaries	(7,968)	125,850	(30,848)		87,034
Income tax (benefit) expense	(5,567)	47,361	(11,447)		30,347
Equity income of subsidiaries	59,088			(59,088)	
Net income (loss)	$ 56,687	$ 78,489	$ (19,401)	$ (59,088)	$ 56,687

Table of Contents

NewMarket Corporation and Subsidiaries

Consolidating Statements of Income

Third Quarter Ended September 30, 2008

(in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
Net sales	$	$ 238,452	$ 202,152	$	$ 440,604
Cost of goods sold		203,953	163,073		367,026
Gross profit		34,499	39,079		73,578
Selling, general, and administrative expenses	1,099	23,003	4,374		28,476
Research, development, and testing expenses		15,206	4,265		19,471
Operating (loss) profit	(1,099)	(3,710)	30,440		25,631
Interest and financing expenses (income)	3,102	(306)	170		2,966
Other income, net	11	59	152		222
(Loss) income before income tax (benefit) expense and equity income of subsidiaries	(4,190)	(3,345)	30,422		22,887
Income tax (benefit) expense	(2,550)	(707)	9,672		6,415
Equity income of subsidiaries	18,112			(18,112)	
Net income (loss)	$ 16,472	$ (2,638)	$ 20,750	$ (18,112)	$ 16,472

26

Table of Contents

NewMarket Corporation and Subsidiaries

Consolidating Statements of Income

Nine Months Ended September 30, 2009

(in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
Net sales	$	$ 628,203	$ 497,678	$	$ 1,125,881
Cost of goods sold		305,482	474,945		780,427
Gross profit		322,721	22,733		345,454
Selling, general, and administrative expenses	3,474	68,783	10,884		83,141
Research, development, and testing expenses		47,675	13,773		61,448
Operating (loss) profit	(3,474)	206,263	(1,924)		200,865
Interest and financing expenses (income)	8,991	(495)	208		8,704
Other (expense) income, net	(15,759)	42	(17)		(15,734)
(Loss) income before income tax (benefit) expense and equity income of subsidiaries	(28,224)	206,800	(2,149)		176,427
Income tax (benefit) expense	(15,129)	77,874	(2,351)		60,394
Equity income of subsidiaries	129,128			(129,128)	
Net income	$ 116,033	$ 128,926	$ 202	$ (129,128)	$ 116,033

Table of Contents

NewMarket Corporation and Subsidiaries

Consolidating Statements of Income

Nine Months Ended September 30, 2008

(in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
Net sales	$	$ 666,330	$ 582,506	$	$ 1,248,836
Cost of goods sold		502,765	508,697		1,011,462
Gross profit		163,565	73,809		237,374
Selling, general, and administrative expenses	3,587	71,319	12,842		87,748
Research, development, and testing expenses		46,538	15,041		61,579
Operating (loss) profit	(3,587)	45,708	45,926		88,047
Interest and financing expenses (income)	9,159	(859)	554		8,854
Other income, net	347	12	542		901
(Loss) income before income tax (benefit) expense and equity income of subsidiaries	(12,399)	46,579	45,914		80,094
Income tax (benefit) expense	(7,960)	18,903	15,283		26,226
Equity income of subsidiaries	58,307			(58,307)	
Net income	$ 53,868	$ 27,676	$ 30,631	$ (58,307)	$ 53,868

28

Table of Contents

NewMarket Corporation and Subsidiaries

Consolidating Balance Sheets

September 30,2009

(in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
ASSETS					
Cash and cash equivalents	$ 31,900	$ 45,456	$ 56,414	$	$ 133,770
Short-term investments	300				300
Trade and other accounts receivable, net		113,527	116,076		229,603
Amounts due from affiliated companies	(4,183)	236,909	38,798	(271,524)	
Inventories		100,100	82,357		182,457
Deferred income taxes	2,519	6,713	18,445		27,677
Prepaid expenses and other current assets	3,617	4,035	1,489		9,141
Total current assets	34,153	506,740	313,579	(271,524)	582,948
Amounts due from affiliated companies		19,879	7,500	(27,379)	
Property, plant and equipment, at cost		766,918	156,023		922,941
Less accumulated depreciation & amortization		513,644	115,848		629,492
Net property, plant and equipment		253,274	40,175		293,449
Investment in consolidated subsidiaries	678,555			(678,555)	
Prepaid pension cost			36		36
Deferred income taxes	35,939	959	3,256		40,154
Other assets and deferred charges	24,388	15,404	1,491		41,283
Intangibles, net of amortization and goodwill		47,271			47,271
Total assets	$ 773,035	$ 843,527	$ 366,037	$ (977,458)	$ 1,005,141
LIABILITIES AND SHAREHOLDERS EQUITY					
Accounts payable	$ 11	$ 63,825	$ 36,611	$	$ 100,447
Accrued expenses	11,400	40,492	15,100		66,992
Dividends payable	3,319				3,319
Book overdraft		2,896			2,896
Amounts due to affiliated companies	108,039	77,037	86,448	(271,524)	
Long-term debt, current portion		86,055			86,055
Income taxes payable	(9,901)	28,432	3,810		22,341
Total current liabilities	112,868	298,737	141,969	(271,524)	282,050
Long-term debt	150,000	358			150,358
Amounts due to affiliated companies		7,500	19,879	(27,379)	
Other noncurrent liabilities	97,717	44,272	18,294		160,283

Total liabilities	360,585	350,867	180,142	(298,903)	592,691
Shareholders equity:					
Common stock and paid-in capital	266	318,215	75,479	(393,694)	266
Accumulated other comprehensive loss	(79,963)	(17,312)	(37,607)	54,919	(79,963)
Retained earnings	492,147	191,757	148,023	(339,780)	492,147
Total shareholders equity	412,450	492,660	185,895	(678,555)	412,450
Total liabilities and shareholders equity	$ 773,035	$ 843,527	$ 366,037	$ (977,458)	$ 1,005,141

29

Table of Contents

NewMarket Corporation and Subsidiaries

Consolidating Balance Sheets

December 31, 2008

(in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
ASSETS					
Cash and cash equivalents	$	$ 4,408	$ 17,353	$	$ 21,761
Trade and other accounts receivable, net	1,307	102,982	99,262		203,551
Amounts due from affiliated companies	233,526	261,153	33,748	(528,427)	
Inventories		97,742	103,330		201,072
Deferred income taxes	2,134	8,204	3,752		14,090
Prepaid expenses and other current assets	2,865	1,885	954		5,704
Total current assets	239,832	476,374	258,399	(528,427)	446,178
Amounts due from affiliated companies		19,783	7,500	(27,283)	
Property, plant and equipment, at cost		713,384	134,627		848,011
Less accumulated depreciation & amortization		500,507	105,768		606,275
Net property, plant and equipment		212,877	28,859		241,736
Investment in consolidated subsidiaries	531,400			(531,400)	
Prepaid pension cost			159		159
Deferred income taxes	31,767	(926)	6,903		37,744
Other assets and deferred charges	4,982	25,406	1,178		31,566
Intangibles, net of amortization and goodwill		54,069			54,069
Total assets	$ 807,981	$ 787,583	$ 302,998	$ (1,087,110)	$ 811,452
LIABILITIES AND SHAREHOLDERS EQUITY					
Accounts payable	$ 219	$ 41,996	$ 18,290	$	$ 60,505
Accrued expenses	10,131	43,819	9,765		63,715
Dividends payable	2,646				2,646
Book overdraft		999			999
Amounts due to affiliated companies	227,274	245,456	55,697	(528,427)	
Long-term debt, current portion		784			784
Income taxes payable		1,656	5,608		7,264
Total current liabilities	240,270	334,710	89,360	(528,427)	135,913
Long-term debt	191,900	44,478			236,378
Amounts due to affiliated companies		7,500	19,783	(27,283)	
Other noncurrent liabilities	84,688	42,438	20,912		148,038
Total liabilities	516,858	429,126	130,055	(555,710)	520,329

Shareholders equity:					
Common stock and paid-in capital	115	317,234	74,909	(392,143)	115
Accumulated other comprehensive loss	(95,750)	(17,723)	(52,122)	69,845	(95,750)
Retained earnings	386,758	58,946	150,156	(209,102)	386,758
Total shareholders equity	291,123	358,457	172,943	(531,400)	291,123
Total liabilities and shareholders equity	$ 807,981	$ 787,583	$ 302,998	$ (1,087,110)	$ 811,452

30

Table of Contents

NewMarket Corporation and Subsidiaries

Condensed Consolidating Statements of Cash Flows

Nine Months Ended September 30, 2009

(in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
Cash provided from operating activities	$ (13,226)	$ 161,666	$ 46,177	$	$ 194,617
Cash flows from investing activities:					
Capital expenditures		(14,101)	(12,405)		(26,506)
Foundry Park I capital expenditures		(40,403)			(40,403)
Purchase of short-term investment	(300)				(300)
Deposits for interest rate lock agreement		(5,000)			(5,000)
Return of deposits for interest rate lock agreement		15,500			15,500
Return of deposits for interest rate swap	9,930				9,930
Deposits for interest rate swap	(29,900)				(29,900)
Decrease in intercompany loans		(403)		403	
Cash dividends from subsidiaries	118,321			(118,321)	
Cash provided from (used in) investing activities	98,051	(44,407)	(12,405)	(117,918)	(76,679)
Cash flows from financing activities:					
Draws on Foundry Park I construction loan		41,735			41,735
Net repayments under revolving credit agreement	(41,900)				(41,900)
Dividends	(10,644)	(118,321)		118,321	(10,644)
Change in book overdraft, net		1,897			1,897
Payment for financed intangible asset		(750)			(750)
Debt issuance costs	(412)				(412)
Proceeds from exercise of stock options	31				31
Financing from affiliated companies			13,402	(13,402)	
Repayment of intercompany note payable			(12,999)	12,999	
Payments on the capital lease		(584)			(584)
Cash used in (provided from) financing activities	(52,925)	(76,023)	403	117,918	(10,627)
Effect of foreign exchange on cash and cash equivalents		(188)	4,886		4,698
Increase in cash and cash equivalents	31,900	41,048	39,061		112,009
Cash and cash equivalents at beginning of year		4,408	17,353		21,761
Cash and cash equivalents at end of period	$ 31,900	$ 45,456	$ 56,414	$	$ 133,770

31

Table of Contents

NewMarket Corporation and Subsidiaries

Condensed Consolidating Statements of Cash Flows

Nine Months Ended September 30, 2008

(in thousands)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
Cash (used in) provided from operating activities	$ (37,269)	$ 49,621	$ (789)	$	$ 11,563
Cash flows from investing activities:					
Capital expenditures		(15,086)	(6,745)		(21,831)
Foundry Park I capital expenditures		(29,046)			(29,046)
Acquisition of business		(14,721)			(14,721)
Return of deposits for interest rate lock agreement		1,050			1,050
Decrease (increase) in intercompany loans		313	(5,500)	5,187	
Cash dividends from subsidiaries	24,424			(24,424)	
Cash provided from (used in) investing activities	24,424	(57,490)	(12,245)	(19,237)	(64,548)
Cash flows from financing activities:					
Draws on Foundry Park I construction loan		25,083			25,083
Net borrowings under revolving credit agreement	31,800				31,800
Repurchases of common stock	(26,810)				(26,810)
Dividends	(12,090)	(24,424)		24,424	(12,090)
Change in book overdraft, net	(22)	(1,615)			(1,637)
Payment for financed intangible asset		(750)			(750)
Proceeds from exercise of stock options	246				246
Excess tax benefits from stock-based payment arrangements	900				900
Repayment of intercompany note payable			(313)	313	
Financing from affiliated companies		5,500		(5,500)	
Payments on the capital lease		(548)			(548)
Cash (used in) provided from financing activities	(5,976)	3,246	(313)	19,237	16,194
Effect of foreign exchange on cash and cash equivalents		(305)	(1,285)		(1,590)
Decrease in cash and cash equivalents	(18,821)	(4,928)	(14,632)		(38,381)
Cash and cash equivalents at beginning of year	18,899	13,673	39,300		71,872
Cash and cash equivalents at end of period	$ 78	$ 8,745	$ 24,668	$	$ 33,491

Table of Contents

14. Subsequent Events

We have performed an evaluation of subsequent events through our filing of the Quarterly Report on Form 10-Q on October 27, 2009.

On October 22, 2009, our Board of Directors declared a quarterly dividend in the amount of 37.5 cents per share on our common stock. The dividend is payable January 1, 2010 to shareholders of record at the close of business on December 15, 2009.

Table of Contents

ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
Forward-Looking Statements

The following discussion contains forward-looking statements about future events and expectations within the meaning of the Private Securities Litigation Reform Act of 1995. We have based these forward-looking statements on our current expectations and projections about future results. When we use words in this document, such as anticipates, intends, plans, believes, estimates, expects, should, could, may, similar expressions, we do so to identify forward-looking statements. Examples of forward-looking statements include, but are not limited to, statements we make regarding future prospects of growth in the petroleum additives market, other trends in the petroleum additives market, our ability to maintain or increase our market share, and our future capital expenditure levels.

We believe our forward-looking statements are based on reasonable expectations and assumptions, within the bounds of what we know about our business and operations. However, we offer no assurance that actual results will not differ materially from our expectations due to uncertainties and factors that are difficult to predict and beyond our control.

These factors include, but are not limited to, changes in the demand for our products, increases in product cost and our ability to increase prices, timing of sales orders, gain or loss of significant customers, competition from other manufacturers and resellers, resolution of environmental liabilities, significant changes in new product introduction, the impact of fluctuations in foreign exchange rates on reported results of operations, changes in various markets, geopolitical risks in certain of the countries in which we conduct business, our ability to complete the construction of the office building for MeadWestvaco within budget and in a timely manner and obtain replacement financing for the construction loan, changes in credit market conditions, and other factors detailed from time to time in the reports we file with the SEC, including the risk factors in Item 1A, Risk Factors, in the 2008 Annual Report. Readers are urged to review and consider carefully the disclosures we make in our filings with the SEC.

You should keep in mind that any forward-looking statement made by us in this discussion or elsewhere speaks only as of the date on which we make it. New risks and uncertainties arise from time to time, and it is impossible for us to predict these events or how they may affect us. We have no duty to, and do not intend to, update or revise the forward-looking statements in this discussion after the date hereof, except as may be required by law. In light of these risks and uncertainties, you should keep in mind that the events described in any forward-looking statement, made in this discussion or elsewhere, might not occur.

Overview

Operations during the first nine months of 2009 continued to generate very strong results with operating profit in our petroleum additives segment increasing significantly over the first nine months of 2008. Our financial position remains strong. During the year, we have paid down $41.9 million of outstanding debt on our revolving credit facility and our cash increased to $133.8 million, which was $112.0 million higher than the December 31, 2008 balance.

Table of Contents

Results of Operations

Net Sales

Our consolidated net sales for the third quarter 2009 amounted to $417.8 million, representing a decrease of approximately 5% from the 2008 third quarter level of $440.6 million. Nine months 2009 consolidated net sales decreased 10% to $1,125.9 million as compared to $1,248.8 million for nine months 2008. The table below shows our consolidated segment net sales.

Segment Net Sales

(in millions)

	Third Quarter Ended September 30		Nine Months Ended September 30	
	2009	**2008**	**2009**	**2008**
Petroleum additives	$ 413.7	$ 437.2	$ 1,116.7	$ 1,238.8
All other	4.1	3.4	9.2	10.0
Consolidated net sales	$ 417.8	$ 440.6	$ 1,125.9	$ 1,248.8

Petroleum Additives Segment

Petroleum additives net sales for the third quarter 2009 of $413.7 million decreased $23.5 million, or approximately 5%, from $437.2 million for the third quarter 2008. The decrease in sales reflects reductions in total product shipments of 3%. A decrease in shipments in lubricant additives product lines more than offset a moderate increase in fuel additives product line shipments. Also, included in the reduction in net sales between the 2009 and 2008 third quarter periods is an unfavorable foreign currency impact of approximately $8 million. This unfavorable impact from foreign exchange reflects the strengthening of the U.S. Dollar between the two third quarter periods versus the other currencies in which we conduct business. In addition to the unfavorable impacts from lower product shipments and foreign currency, selling prices were also lower when comparing the two third quarter periods.

Nine months 2009 petroleum additive net sales of $1,116.7 million were approximately 10% lower than nine months 2008 results of $1,238.8 million. Similar to the third quarter results, the decrease between the two nine months periods reflects lower product shipments and a significant unfavorable foreign currency impact of $33.3 million. Product shipments were approximately 16% lower for nine months 2009 than the same 2008 period. The decrease was primarily in the lubricant additives product lines. These factors were partially offset by higher selling prices which were implemented during 2008. The decrease in net sales for the nine months 2009 period reflects the impact of the worldwide economic slowdown and the destocking by our customers late in 2008 and early 2009. While product shipments were lower in 2009 than in 2008, product shipments have improved each quarter in 2009 increasing 16% between the first quarter 2009 and second quarter 2009 and increasing 14% between the second quarter 2009 and third quarter 2009. We believe product shipments are now near normal levels that were typical before the worldwide economic slowdown.

Table of Contents

The table below details the approximate components of the decrease between the two third quarter and nine months periods.

	Third Quarter (in millions)	Nine Months (in millions)
Period ended September 30, 2008	$ 437.2	$ 1,238.8
Decrease in shipments and changes in product mix	(4.1)	(163.3)
Change in selling prices, customer mix, and foreign currency	(19.4)	41.2
Period ended September 30, 2009	$ 413.7	$ 1,116.7

Segment Operating Profit

NewMarket evaluates the performance of the petroleum additives business based on segment operating profit. NewMarket Services Corporation (NewMarket Services) departments and other expenses are charged to NewMarket and each subsidiary pursuant to service agreements between the companies. Depreciation on segment property, plant, and equipment, as well as amortization of segment intangible assets is included in segment operating profit.

The All other category includes the real estate development operating segment, as well as the operations of the TEL business (primarily sales of TEL in North America) and certain contract manufacturing that Ethyl provides to Afton and to third parties. Each of these is currently immaterial to operating profit.

The table below reports segment operating profit for the third quarter and nine months ended September 30, 2009 and September 30, 2008.

Segment Operating Profit

(in millions)

	Third Quarter Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Petroleum additives	$ 96.3	$ 28.1	$ 214.0	$ 97.5
All other	$ 1.0	$ 0.5	$ (1.3)	$ 1.0

Petroleum Additives Segment

The petroleum additives operating profit increased $68.2 million when comparing third quarter 2009 to third quarter 2008 and $116.5 million when comparing nine months 2009 to nine months 2008. The operating profit margin was 23.3% for third quarter 2009 and 6.4% for third quarter 2008. Similarly, the petroleum additives operating profit margin was 19.2% for nine months 2009 and 7.9% for nine months 2008. The 2008 nine months period included a gain of $3.2 million resulting from a legal settlement related to raw materials. The third quarter 2009 and nine months 2009 results are significantly higher across all major product lines.

Table of Contents

While selling prices are lower when comparing third quarter 2009 and third quarter 2008, operating margins, as discussed above, for third quarter 2009 are significantly improved over third quarter 2008 due primarily to the lower raw material costs and a favorable foreign currency impact of approximately $4 million. Product shipments, which are discussed in the Net Sales section, were slightly lower during third quarter 2009 than third quarter 2008. During the third quarter 2009, we have experienced increasing raw material costs and tightening in the availability of certain raw materials, as well as compression of selling prices.

The most significant favorable factors when comparing operating profit for the two nine months periods were lower raw material costs and higher selling prices. While partially offset by selling price reductions made this year, the overall increase in selling prices for the 2009 nine months period is the result of actions taken throughout 2008 to raise selling prices in response to higher raw material costs. The key unfavorable factors were lower shipments and foreign currency impacts. Foreign currency resulted in an unfavorable impact of approximately $9 million when comparing operating profit from nine months 2009 with nine months 2008.

SG&A decreased approximately $500 thousand or 2% for third quarter 2009, while R&D increased approximately $2.1 million or 11% when compared to the same 2008 period. For nine months 2009, SG&A decreased $5.4 million or 7%, and R&D was essentially unchanged compared to nine months 2008. The changes for both the third quarter periods and nine months periods included a significant favorable foreign currency impact. We continue to invest in SG&A and R&D to support our customers programs and to develop the technology required to remain a leader in this industry.

The following discussion references the Consolidated Financial Statements beginning on page 3 of this Quarterly Report on Form 10-Q.

Interest and Financing Expenses

Interest and financing expenses were $2.9 million for third quarter 2009 and $3.0 million for third quarter 2008. Nine months 2009 amounted to $8.7 million, while nine months 2008 was $8.9 million.

Average interest rates for the third quarter 2009 were slightly higher than third quarter 2008, while average debt during third quarter 2009 was lower as we had no debt drawn on the revolving credit facility during third quarter 2009. Amortization of deferred financing costs was higher due to the cost related to increased commitment levels achieved on the revolving credit facility. See Note 7 in the Notes to Consolidated Financial Statements.

Nine months 2009 average interest rates were essentially unchanged from the same 2008 period. The benefit of lower average debt for nine months 2009 when compared to nine months 2008 was substantially offset by higher amortization of deferred financing costs in 2009.

Other (Expense) Income, Net

Other expense, net for third quarter 2009 was $3.8 million, while nine months 2009 was $15.7 million. The amount in both 2009 periods represents an unrealized loss on a derivative instrument representing an interest rate swap recorded at fair value, which we entered into on June 25, 2009. See Note 9 in the Notes to Consolidated Financial Statements for additional information on the interest rate swap. Other income, net was $200 thousand for third quarter 2008 and $900 thousand for nine months 2008 and primarily represented investment income earned on excess cash.

Income Tax Expense

Income tax expense was $30.3 million for the third quarter 2009 and $6.4 million for third quarter 2008. The effective tax rate was 34.9% for third quarter 2009 and 28.0% for third quarter 2008.

Table of Contents

The increase in income before income tax expense resulted in an increase of $18.0 million in income taxes, while the higher effective tax rate in 2009 as compared to 2008 resulted in an increase of approximately $5.9 million in income taxes when comparing the third quarter 2009 and 2008 periods.

Nine months 2009 income tax expense was $60.4 million with an effective tax rate of 34.2%. Income tax expense for nine months 2008 was $26.2 million with an effective tax rate of 32.7%. The increase in income before income tax expense from 2008 to 2009 resulted in an increase of $31.6 million. The higher effective tax rate for nine months 2009 resulted in an increase in income tax expense of $2.6 million.

The lower effective tax rates for both third quarter 2008 and nine months 2008 includes the benefit of $1 million related to the completion of the review of certain years by the Internal Revenue Service. The increased effective tax rates in both third quarter 2009 and nine months 2009 reflect the higher proportion of domestic earnings in 2009, which are subject to both U.S. federal and state income taxes.

Cash Flows, Financial Condition, and Liquidity

Cash and cash equivalents at September 30, 2009 were $133.8 million, which was an increase of $112.0 million since December 31, 2008 and included a $4.7 million favorable impact from foreign currency translation.

We expect that cash from operations, together with borrowing available under our revolving credit facility, will continue to be sufficient to cover our operating expenses for the foreseeable future.

Cash Flows Operating Activities

Cash flows provided from operating activities for the nine months 2009 were $194.6 million and included a decrease of $67.3 million in working capital, including lower inventories, as well as higher accounts payable and higher income taxes payable. The decrease in working capital was partially offset by an increase in accounts receivable. The decrease in inventories reflects the results of our efforts to lower inventories in response to the decreased demand for our products. The increase in accounts payable reflects a normal increase from an unusually low level of accounts payable at December 31, 2008. The increase in income taxes payable reflects the higher earnings levels in 2009. The increase in accounts receivable is due to the increased sales levels for third quarter 2009 compared to fourth quarter 2008.

Including cash and the current portion of long-term debt, we had working capital of $300.9 million at September 30, 2009 and $310.3 million at December 31, 2008. The current ratio was 2.07 to 1 at September 30, 2009 and 3.28 to 1 at December 31, 2008. In addition to the working capital factors discussed above, the change in the current portion of long-term debt had a significant effect on working capital levels resulting from the construction loan becoming payable within one year.

Cash Flows Investing Activities

Cash used in investing activities was $76.7 million during nine months 2009 and included a net return of funds of $10.5 million for a deposit related to the interest rate lock agreement, which is discussed below, as well as net funding of $20.0 million for a deposit related to the Goldman Sachs interest rate swap. Further information on the interest rate swap is discussed below and in

Table of Contents

Note 9 in the Notes to Consolidated Financial Statements. Excluding the construction of the office building by Foundry Park I, we funded capital expenditures of $26.5 million through September 30, 2009. We estimate our total capital spending during 2009, excluding the capital expenditures by Foundry Park I, will be approximately $40 million. We expect to continue to finance capital spending, excluding the expenditures for the construction of the office building by Foundry Park I, through cash on hand and cash provided from operations, together with borrowing available under our revolving credit facility.

Capital expenditures during nine months 2009 related to the Foundry Park I project amounted to $40.4 million. We expect capital expenditures in 2009 related to the construction of the office building will be approximately $59 million which will be substantially borrowed under our construction loan.

Cash Flows Financing Activities

Cash used in financing activities during nine months 2009 amounted to $10.6 million. The use of cash included the funding of dividends of $10.6 million, as well as debt issuance costs of $400 thousand and a payment of $750 thousand on the fourth quarter 2006 acquisition of an intangible asset. Our book overdraft increased $1.9 million.

We had total long-term debt, including the current portion, of $236.4 million at September 30, 2009, representing a decrease of approximately $800 thousand in our total debt since December 31, 2008. The decrease resulted from the payment of $41.9 million under the revolving credit facility and $600 thousand on capital leases, which was substantially offset by borrowings on the construction loan of $41.7 million.

In addition to the Foundry Park I construction loan which is discussed below, at September 30, 2009, we had outstanding senior notes in the aggregate principal amount of $150 million that bear interest at a fixed rate of 7.125% and are due in 2016.

At September 30, 2009, we also had a $139.25 million revolving credit facility for general corporate purposes that bears interest at variable rates. The revolving credit facility includes a $75 million sub-facility for letters of credit. The facility matures on December 21, 2011. At September 30, 2009, we had no outstanding borrowings under the revolving credit facility. We had outstanding letters of credit of $4.6 million at September 30, 2009, resulting in the unused portion of the revolver amounting to $134.7 million.

Both the senior notes and the revolving credit facility contain covenants, representations, and events of default that management considers typical of credit agreements of this nature. We were in compliance with these covenants as of both September 30, 2009 and December 31, 2008.

As a percentage of total capitalization (total debt and shareholders equity), our total debt percentage decreased from 44.9% at the end of 2008 to 36.4% at September 30, 2009. The change in the percentage was primarily the result of an increase in shareholders equity, as well as the small decrease in debt. The increase in shareholders equity reflects our earnings, partially offset by the impact of dividend payments. Normally, we repay any outstanding long-term debt with cash from operations or refinancing activities.

Foundry Park I Construction Loan and Interest Rate Swap

Foundry Park I and NewMarket Corporation entered into a construction loan agreement with a group of banks on August 7, 2007 to borrow up to $116 million to fund the development and construction of an office building. The construction loan bears interest at LIBOR plus a margin of

140 basis points. The term of the loan is for a period of 36 months and is unconditionally guaranteed by NewMarket Corporation. No principal reduction payment is due during the construction period. As a condition of the construction loan and concurrently with the closing of the loan, Foundry Park I also obtained interest rate risk protection in the form of an interest rate swap. The interest rate swap is discussed in Note 9 in the Notes to Consolidated Financial Statements.

Interest Rate Lock Agreement

The construction loan for the Foundry Park I project to construct an office building for MeadWestvaco is being financed by a group of banks and matures in August 2010. Prior to commencing construction, we took actions to identify the possible permanent lending source after construction. To that end, Foundry Park I entered into an Application with Principal dated February 26, 2007 which outlined the terms and conditions under which Principal would provide permanent, fixed-rate financing in the maximum amount of $116,000,000 amortized over 25 years with all amounts due 13.5 years after the date of the loan. The Application was not a loan commitment due to the lengthy time period of thirty-four months until the completion of the building. In order to obtain a fixed-rate loan, we entered into a rate lock agreement with Principal dated February 26, 2007. Principal simultaneously entered into a hedge with a third party based mainly on the forward rates of ten-year Treasuries. We were not a party to that hedging agreement. Under the rate lock agreement, we agreed to post a deposit with Principal and to increase the amount of that deposit if the exposure to Principal on their hedge increased.

In June 2009, Principal and Foundry Park I determined that the loan terms set forth in the Application could not be syndicated based on current market conditions. As a result, Principal and Foundry Park I terminated the loan application and related rate lock agreement and mutually released each other from their respective rights and obligations under those arrangements. While we are currently investigating alternative financing to replace the Foundry Park I project construction loan when it matures and believe that we can obtain financing on acceptable terms, we cannot predict the financing terms which will be available at that time. See Note 9 for additional information on the termination of the rate lock agreement and subsequent entry into an interest rate swap related to the Foundry Park I project. All amounts which we had deposited with Principal under the rate lock agreement have effectively been returned to us at the termination of the rate lock agreement as Principal transferred the deposited funds to Goldman Sachs as collateral for the interest rate swap related to the Foundry Park I project.

Critical Accounting Policies

This report, as well as the 2008 Annual Report, includes a discussion of our accounting principles, as well as methods and estimates used in the preparation of our financial statements. We believe these discussions and financial statements fairly represent the financial position and operating results of our company in all material respects. The purpose of this portion of our discussion is to further emphasize some of the more critical areas where a significant change in facts and circumstances in our operating and financial environment might cause a change in reported financial results.

Intangibles, Net of Amortization and Goodwill

We have certain identifiable intangibles, as well as goodwill, amounting to $47.3 million at September 30, 2009. These intangibles relate to our petroleum additives business and, except for the goodwill, are being amortized over periods with up to approximately twenty years of remaining life. We continue to assess the market related to these intangibles, as well as their specific values, and have concluded the values and amortization periods are appropriate. We also

Table of Contents

evaluate these intangibles for any potential impairment when significant events or circumstances occur that might impair the value of these assets. These evaluations continue to support the value at which these identifiable intangibles are carried on our financial statements. However, if conditions were to substantially deteriorate in this market, it could possibly cause a reduction in the periods of the amortization charge or result in a noncash write-off of a portion of the intangibles carrying value. A reduction in the amortization period would have no effect on cash flows. We do not anticipate such a change in the market conditions.

Environmental and Legal Proceedings

We believe our environmental accruals are appropriate for the exposures and regulatory guidelines under which we currently operate. While we currently do not anticipate significant changes to the many factors that could impact our environmental requirements, we continue to keep our accruals consistent with these requirements as they change.

While it is not possible to predict or determine with certainty the outcome of any legal proceeding, it is our opinion, based on our current knowledge, that we will not experience materially adverse effects on our results of operations or financial condition as a result of any pending or threatened proceeding.

Pension Plans and Other Postretirement Benefits

We use assumptions to record the impact of the pension and postretirement plans in the financial statements. These assumptions include the discount rate, expected long-term rate of return on plan assets, rate of compensation increase, and health care cost trend rate. A change in any one of these assumptions could result in different results for the plans. We develop these assumptions after considering available information that we deem relevant. Information is provided on the pension and postretirement plans in Note 18 of the 2008 Annual Report. In addition, further disclosure on the effect of changes in these assumptions is provided in the Financial Position and Liquidity section of Part II, Item 7 of the 2008 Annual Report.

Income Taxes

We file consolidated U.S. federal income and both consolidated and individual state income tax returns, as well as individual foreign income tax returns, under which assumptions may be made to determine the deductibility of certain costs. We make estimates related to the impact of tax positions taken on our financial statements when we believe the tax position is more likely than not to be upheld on audit. In addition, we make certain assumptions in the determination of the estimated future recovery of deferred tax assets.

Recently Issued Accounting Pronouncements

For a full discussion of the more significant pronouncements which may impact our financial statements, see Note 12 in the Notes to Consolidated Financial Statements.

Outlook

The performance of our business for the first nine months of this year has been outstanding. We have actively managed our business during very challenging economic times and are confident in our strategy to serve our customers by helping them succeed in their marketplace by providing innovative solutions. We feel our financial results are a measure of how we are performing against that strategy.

Table of Contents

We believe that our overall business has returned to more historical levels of demand. We further believe that the contraction associated with destocking and shrinking demand due to economic conditions has ended. For the first nine months of 2009, our product shipments were 16% lower than the first nine months of last year. When considering only the third quarter, our shipments were only 3% lower. While we are still somewhat cautious in our outlook for demand due to an uncertain economic outlook for the world, we are encouraged by the third quarter results. Our plants are running at very high rates, raw material costs are beginning to increase, which is a general trend we expect going forward, and we are experiencing some tightness in raw material availability. Additionally, we are spending at a higher rate in R&D and in Health and Environmental areas in support of our customers, as well as in response to various legislative changes around the world.

In late July, we announced that we are expanding our supply chain capabilities by investing in a manufacturing facility in Singapore. This new plant will enable us to better serve our customers in that region with shorter lead-times and improved security of supply. In addition, the facility will allow us to manufacture to the specifications of our customers in the region with our most current technology. While the initial capacity will represent a small increase to our overall global production capacity, the facility will be scalable, allowing us to add capacity as demand in that region grows. We expect that this facility will be in production during the first half of 2010, with the majority of the cash being spent in 2009.

Our project to construct a multi-story office building for MeadWestvaco continues to progress as expected. The project will be completed later this year. We are continuing our efforts to find financing to replace the construction loan, which is due in August 2010.

As we have communicated in the past, we intend to leverage our financial strength to increase shareholder value by growing the business, with acquisitions being an area of primary interest. Our primary focus in the acquisition area remains on the petroleum additives industry. It is our view that this industry will provide the greatest opportunity for a good return on our investment while minimizing risk. We remain focused on this strategy and will evaluate any future opportunities. Nonetheless, we are patient in this pursuit and intend to make the right acquisition for our company if and when the opportunity arises. Meanwhile, we believe we have many internal opportunities for growth from both geographical and product line extensions. As cash builds on our balance sheet, we will continue to evaluate all alternative uses for that cash to enhance shareholder value, including potential stock repurchases and dividends.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Other than our foreign currency risk and the entry into an interest rate swap, there have been no significant changes in our market risk from the information provided in the 2008 Annual Report.

At September 30, 2009, we had $4.2 million in Euro-denominated foreign currency forward contracts outstanding. With other variables held constant, a hypothetical 10% adverse change in the September 30, 2009 forward Euro rates would have resulted in a decrease of approximately $400 thousand in the value of the contracts.

On June 25, 2009, we entered into an interest rate swap with Goldman Sachs. We recorded the derivative at fair value, which amounted to $15.7 million at September 30, 2009. Any change in fair value is recognized immediately in earnings. With other variables held constant, a hypothetical 50 basis point adverse parallel shift in the LIBOR yield curve would have resulted in an increase of approximately $5 million in the fair value liability of the interest rate swap.

Table of Contents

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain a system of internal control over financial reporting to provide reasonable, but not absolute, assurance of the reliability of the financial records and the protection of assets. Our controls and procedures include written policies and procedures, careful selection and training of qualified personnel, and an internal audit program. We use a third-party firm, separate from our independent registered public accounting firm, to assist with internal audit services.

We work closely with the business groups, operations personnel, and information technology to ensure transactions are recorded properly. Environmental and legal staff are consulted to determine the appropriateness of our environmental and legal liabilities for each reporting period. We regularly review the regulations and rule changes that affect our financial disclosures.

Our disclosure control procedures include signed representation letters from our regional officers, as well as senior management.

We have formed a Financial Disclosure Committee, which is made up of the president of Afton, the general counsel of NewMarket, and the controller of NewMarket. The committee, as well as regional management, makes representations with regard to the financial statements that, to the best of their knowledge, the report does not contain any misstatement of a material fact or omit a material fact that is necessary to make the statements not misleading with respect to the periods covered by the report.

The committee and the regional management also represent, to the best of their knowledge, that the financial statements and other financial information included in the report fairly present, in all material respects, the financial condition, results of operations and cash flows of the company as of and for the periods presented in the report.

Pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934 (the Exchange Act), we carried out an evaluation, with the participation of our management, including our principal executive officer and our principal financial officer, of the effectiveness of our disclosure controls and procedures (as defined under Rule 13a-15(e)) under the Exchange Act as of the end of the period covered by this report. Based upon that evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures are effective.

There has been no change in our internal control over financial reporting, as such term is defined in Rule 13a-15(f) under the Exchange Act, during the quarter ended September 30, 2009, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II Other Information

ITEM 1. Legal Proceedings

We are involved in legal proceedings that are incidental to our business and include administrative or judicial actions seeking remediation under environmental laws, such as Superfund. Some of these legal proceedings relate to environmental matters and involve governmental authorities. For further information, see Environmental in Part I, Item 1 of our 2008 Annual Report.

While it is not possible to predict or determine with certainty the outcome of any legal proceeding, we believe the outcome of any of these proceedings, or all of them combined, will not result in a material adverse effect on our consolidated financial condition or results of operations.

ITEM 1A. Risk Factors

While we attempt to identify, manage, and mitigate risks and uncertainties associated with our business to the extent practical under the circumstances, some level of risk and uncertainty will always be present. Part I, Item 1A of our 2008 Annual Report describes some of the risks and uncertainties associated with our business. These risks and uncertainties have the potential to materially affect our results of operations and our financial condition. We do not believe that there have been any material changes to the risk factors previously disclosed in our 2008 Annual Report except as highlighted below.

Development, construction, and permanent financing risks associated with Foundry Park I could adversely affect our financial results we may incur losses, which could be material, for breakage fees under an interest rate lock agreement in connection with our application for permanent financing.

As previously discussed in this Quarterly Report on Form 10-Q, during the second quarter 2009, Principal and Foundry Park I terminated the interest rate lock agreement. As a result, this risk factor no longer exists.

We may incur losses, which could be material, related to the Goldman Sachs interest rate swap if the forward rates for three month LIBOR decrease significantly.

ITEM 6. Exhibits

Exhibit 3.1	Articles of Incorporation (incorporated by reference to Exhibit 3.1 to Form 10-K (File No. 1-32190) filed March 14, 2005)
Exhibit 3.2	NewMarket Corporation Bylaws Amended and Restated effective April 23, 2009 (incorporated by reference to Exhibit 3.1 to Form 8-K (File No. 1-32190) filed February 23, 2009)
Exhibit 31(a)	Certification pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by Thomas E. Gottwald

Exhibit 31(b)	Certification pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by David A. Fiorenza
Exhibit 32(a)	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Thomas E. Gottwald
Exhibit 32(b)	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by David A. Fiorenza

Table of Contents

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.

	NEWMARKET CORPORATION (Registrant)	
Date: October 27, 2009	By:	/s/ D. A. FIORENZA **David A. Fiorenza** **Vice President and Treasurer** **(Principal Financial Officer)**
Date: October 27, 2009	By:	/s/ WAYNE C. DRINKWATER **Wayne C. Drinkwater** **Controller** **(Principal Accounting Officer)**

EXHIBIT INDEX

Exhibit 31(a)	Certification pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by Thomas E. Gottwald
Exhibit 31(b)	Certification pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by David A. Fiorenza
Exhibit 32(a)	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Thomas E. Gottwald
Exhibit 32(b)	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by David A. Fiorenza

px;margin-bottom:0px">See Note 19 to the consolidated financial statements for information about our off-balance sheet arrangements.

Applications of Critical Accounting Policies

The Corporation s consolidated financial statements are prepared in accordance with accounting principles generally accepted in the U.S. and follow general practices within the industries in which the Corporation operates. Application of these principles requires management to make estimates or judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates or judgments. Certain policies inherently have a greater reliance on the use of estimates, and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates or judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third party sources, when available. When third-party information is not available, valuation adjustments are estimated in good faith by management primarily through the use of internal cash flow modeling techniques.

The most significant accounting policies used by the Corporation are presented in Note 1 to the consolidated financial statements. These policies, along with the disclosures presented in the other financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Management views critical accounting policies to be those which are highly dependent on subjective or complex judgments, estimates and assumptions, and where changes in those estimates and assumptions could have a significant impact on the financial statements.

A material estimate that is susceptible to significant change is the determination of the allowance for loan losses. The Corporation s methodology for determining the allowance for loan losses is described previously in Management s Discussion and Analysis. Given the subjective nature of identifying and valuing loan losses, it is likely that well-informed individuals could make materially different assumptions and could therefore calculate a materially different allowance value. While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in future years. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation s allowance for loan losses. Such agencies may require the Corporation to recognize adjustments to the allowance based on their judgments of information available to them at the time of their examination.

Another material estimate is the calculation of fair values of the Corporation s debt securities. For most of the Corporation s debt securities, the Corporation receives estimated fair values from an independent valuation service or from brokers. In developing fair values, the valuation service and the brokers use estimates of cash flows, based on historical performance of similar instruments in similar interest rate environments. Based on experience, management is aware that estimated fair values of debt securities tend to vary among brokers and other valuation services.

Finally, the fair value of assets acquired and liabilities assumed in connection with the acquisition of FC Banc Corp., including the associated goodwill that was recorded, required the use of material estimates. Specifically, the fair values of loans, the core deposit intangible asset, premises and equipment, and time

Table of Contents

deposits were susceptible to estimation and management s judgment about real estate and equipment values, as well as the amount and timing of future cash flows associated with loans and deposits.

ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

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

Asset-liability modeling techniques and simulation involve assumptions and estimates that inherently cannot be measured with precision. Key assumptions in these analyses include maturity and repricing characteristics of assets and liabilities, prepayments on amortizing assets, non-maturing deposit sensitivity, and loan and deposit pricing. These assumptions are inherently uncertain due to the timing, magnitude, and frequency of rate changes and changes in market conditions and management strategies, among other factors. However, the analyses are useful in quantifying risk and provide a relative gauge of the Corporation s interest rate risk position over time.

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

December 31, 2013		December 31, 2012	
Change in Basis Points	% Change in Net Interest Income	Change in Basis Points	% Change in Net Interest Income
400	-6.2%	400	-0.5%
300	-3.8%	300	-0.8%
100	-0.1%	100	2.3%
(100)	-3.7%	(100)	-4.0%

48

Table of Contents

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

CONSOLIDATED BALANCE SHEETS

Dollars in thousands, except share data

	December 31, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$ 25,769	$ 28,570
Interest bearing deposits with other banks	3,864	3,311
Total cash and cash equivalents	29,633	31,881
Interest bearing time deposits with other banks	275	225
Securities available for sale	685,991	737,311
Trading securities	4,127	4,459
Loans held for sale	487	2,398
Loans	1,299,259	931,225
Less: unearned discount	(3,896)	(3,401)
Less: allowance for loan losses	(16,234)	(14,060)
Net loans	1,279,129	913,764
FHLB and other equity interests	7,533	6,684
Premises and equipment, net	31,589	24,072
Bank owned life insurance	33,804	27,645
Mortgage servicing rights	904	714
Goodwill	27,194	10,946
Core deposit intangible	4,583	-
Accrued interest receivable and other assets	26,040	12,980
Total Assets	$ 2,131,289	$ 1,773,079
LIABILITIES AND SHAREHOLDERS EQUITY		
Non-interest bearing deposits	$ 221,293	$ 175,239
Interest bearing deposits	1,614,021	1,309,764
Total deposits	1,835,314	1,485,003
FHLB and other long-term borrowings	75,000	74,296
Other short-term borrowings	12,950	23,510
Subordinated debentures	20,620	20,620
Accrued interest payable and other liabilities	22,494	24,286
Total liabilities	1,966,378	1,627,715
Common stock, $0 par value; authorized 50,000,000 shares; issued 14,473,482 shares at December 31, 2013 and 12,599,603 shares at December 31, 2012	0	0
Additional paid in capital	77,923	44,223
Retained earnings	97,066	88,960
Treasury stock, at cost (45,702 shares for 2013 and 123,699 for 2012)	(633)	(1,743)

Accumulated other comprehensive income (loss)	(9,445)	13,924
Total shareholders equity	164,911	145,364
Total Liabilities and Shareholders Equity	$ 2,131,289	$ 1,773,079

See Notes to Consolidated Financial Statements

Table of Contents

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

Dollars in thousands, except per share data

	Year ended December 31,		
	2013	2012	2011
Interest and Dividend Income:			
Loans including fees	$ 53,927	$ 49,760	$ 48,324
Securities:			
Taxable	13,456	14,688	14,395
Tax-exempt	3,828	3,595	2,957
Dividends	205	86	36
Total interest and dividend income	71,416	68,129	65,712
Interest Expense:			
Deposits	7,995	10,875	13,625
Borrowed funds	3,447	3,245	3,176
Subordinated debentures (includes $400, $390, and $402 accumulated other comprehensive income reclassification for change in fair value of interest rate swap agreements in 2013, 2012, and 2011)	770	800	778
Total interest expense	12,212	14,920	17,579
Net Interest Income	59,204	53,209	48,133
Provision for Loan Losses	6,138	6,381	4,937
Net Interest Income After Provision for Loan Losses	53,066	46,828	43,196
Non-Interest Income:			
Wealth and asset management fees	2,426	1,819	1,691
Service charges on deposit accounts	4,272	4,106	4,233
Other service charges and fees	2,179	1,868	1,626
Net realized gains on trading securities	579	298	30
Net unrealized gains on trading securities	149	266	34
Mortgage banking	940	990	735
Bank owned life insurance	1,552	973	930
Other	1,314	965	1,224
	13,411	11,285	10,503
Total other-than-temporary impairment losses on available-for-sale securities	0	0	(398)
Less portion of loss recognized in other comprehensive income	0	0	0
Net impairment losses recognized in earnings	0	0	(398)
Net realized gains on available-for-sale securities (includes $355, $1,379, and $614 accumulated other comprehensive income reclassifications for net realized gains on available-for-sale securities in 2013, 2012, and 2011)	355	1,379	614
Net impairment losses recognized in earnings and realized gains on available-for-sale securities	355	1,379	216
Total non-interest income	13,766	12,664	10,719

Non-Interest Expenses:			
Salaries	15,467	13,106	12,349
Employee benefits	6,250	5,787	4,936
Net occupancy expense	5,506	4,651	4,416
Amortization of core deposit intangible	251	0	0
Data processing	3,469	2,791	2,754
State and local taxes	1,549	1,474	1,275
Legal, professional and examination fees	1,318	1,265	956
Advertising	939	859	822
FDIC insurance	1,266	1,115	1,259
Directors fees and benefits	776	666	591
Merger costs	2,396	0	0
Other	4,626	4,231	3,924
Total non-interest expenses	43,813	35,945	33,282
Income Before Income Taxes	23,019	23,547	20,633
Income Tax Expense (includes ($16), $346, and $74 income tax expense reclassification items in 2013, 2012, and 2011)	6,340	6,411	5,529
Net Income	16,679	17,136	15,104
Other Comprehensive Income (Loss):			
Net change in unrealized gains/losses on available-for-sale securities, net of reclassification and tax	(23,675)	3,561	14,441
Change in actuarial gain, net of amortization and tax, for post-employment health care plan, net of tax	(103)	(349)	(485)
Change in fair value of interest rate swap agreements designated as a cash flow hedge, net of tax	409	(49)	(522)
Total other comprehensive income (loss)	(23,369)	3,163	13,434
Comprehensive Income (Loss)	$ (6,690)	$ 20,299	$ 28,538
Earnings Per Share:			
Basic	$ 1.29	$ 1.38	$ 1.23
Diluted	1.29	1.38	1.23

See Notes to Consolidated Financial Statements

Table of Contents

CONSOLIDATED STATEMENTS OF CASH FLOWS

Dollars in thousands

	Year ended December 31,		
	2013	2012	2011
Cash Flows From Operating Activities:			
Net income	$ 16,679	$ 17,136	$ 15,104
Adjustments to reconcile net income to net cash provided by operations:			
Provision for loan losses	6,138	6,381	4,937
Depreciation and amortization of premises and equipment, core deposit intangible, and mortgage servicing rights	2,641	2,225	2,075
Amortization and accretion of securities premiums and discounts, deferred loan fees and costs, net yield and credit mark on acquired loans, and unearned income	3,541	4,509	2,786
Deferred taxes	(977)	(240)	441
Net impairment losses realized in earnings and realized gains on sales of available-for-sale securities	(355)	(1,379)	(216)
Net realized and unrealized gains on trading securities	(728)	(564)	(64)
Proceeds from sale of trading securities	5,811	3,386	343
Purchase of trading securities	(4,671)	(4,187)	(1,266)
Gain on sale of loans	(808)	(927)	(638)
Net gains on dispositions of premises and equipment and foreclosed assets	(252)	(158)	(104)
Proceeds from sale of loans	22,252	32,512	23,324
Origination of loans held for sale	(19,883)	(32,626)	(19,927)
Income on bank owned life insurance	(1,552)	(973)	(930)
Stock-based compensation expense	390	277	213
Contribution of treasury stock	120	120	120
Changes in:			
Accrued interest receivable and other assets	(3,124)	(455)	(1,342)
Accrued interest payable and other liabilities	8,387	2,523	5,529
Net Cash Provided By Operating Activities	33,609	27,560	30,385
Cash Flows from Investing Activities:			
Net (increase) decrease in interest bearing time deposits with other banks	(50)	(1)	2,593
Proceeds from maturities, prepayments and calls of available-for-sale securities	139,863	109,673	101,178
Proceeds from sales of available-for-sale securities	35,633	125,579	69,740
Purchase of available-for-sale securities	(130,412)	(332,155)	(288,757)
Loan origination and payments, net	(124,155)	(82,393)	(58,552)
Purchase of bank owned life insurance	(2,000)	(1,000)	(5,000)
Proceeds from death benefits associated with bank owned life insurance	1,348	0	0
Net cash acquired from FC Banc Corp.	46,982	0	0
Acquisition of consumer discount company	0	(1,248)	0
Redemption (purchase) of FHLB and other equity interests	940	(147)	(122)
Purchase of premises and equipment	(5,336)	(2,016)	(1,705)
Proceeds from the sale of premises and equipment and foreclosed assets	735	1,088	257
Net Cash Used In Investing Activities	(36,452)	(182,620)	(180,368)
Cash Flows From Financing Activities:			
Net change in:			
Checking, money market and savings accounts	48,680	186,262	292,369
Certificates of deposit	(30,395)	(55,110)	(101,386)
Proceeds from sale of treasury stock	41	526	1,188
Proceeds from exercise of stock options	698	424	259
Cash dividends paid	(8,573)	(8,214)	(8,125)
Proceeds from long-term borrowings	900	0	700
Repayments on long-term borrowings	(196)	(160)	(133)
Net change in short-term borrowings	(10,560)	23,510	(32,618)

Net Cash Provided By Financing Activities	595	147,238	152,254
Net (Decrease) Increase in Cash and Cash Equivalents	(2,248)	(7,822)	2,271
Cash and Cash Equivalents, Beginning	31,881	39,703	37,432
Cash and Cash Equivalents, Ending	$ 29,633	$ 31,881	$ 39,703
Supplemental Disclosure of Cash Flow Information:			
Cash paid during the period for:			
Interest	$ 12,283	$ 15,205	$ 17,937
Income taxes	5,529	7,548	3,991
Supplemental Noncash Disclosures:			
Transfers to other real estate owned	$ 1,151	$ 750	$ 249
Grant of restricted stock awards from treasury stock	539	419	266
Net liabilities assumed from FC Banc Corp., excluding cash and cash equivalents	29,669	0	0
Fair value of common stock issued in connection with acquisition of FC Banc Corp.	33,561	0	0

See Notes to Consolidated Financial Statements

Table of Contents

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2013, 2012, AND 2011

Dollars in thousands, except share and per share data

	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Share-holders Equity
Balance, January 1, 2011	$ 44,676	$ 73,059	$ (5,417)	$ (2,673)	$ 109,645
Net income		15,104			15,104
Other comprehensive income				13,434	13,434
Restricted stock award grants (17,900 shares)	(266)		266		
Forfeiture of restricted stock award grants (1,488 shares)	22		(22)		
Exercise of stock options (28,750 shares), including tax benefit	(133)		443		310
Stock based compensation expense	213				213
Reissue of treasury stock (94,895 shares)	(162)		1,470		1,308
Cash dividends declared ($0.66 per share)		(8,125)			(8,125)
Balance, December 31, 2011	44,350	80,038	(3,260)	10,761	131,889
Net income		17,136			17,136
Other comprehensive income				3,163	3,163
Restricted stock award grants (26,900 shares)	(419)		419		
Exercise of stock options (31,875 shares), including tax benefit	(27)		491		464
Stock based compensation expense	277				277
Reissue of treasury stock (39,811 shares)	42		607		649
Cash dividends declared ($0.66 per share)		(8,214)			(8,214)
Balance, December 31, 2012	44,223	88,960	(1,743)	13,924	145,364
Net income		16,679			16,679
Other comprehensive loss				(23,369)	(23,369)
Common stock issued in acquisition (1,873,879 shares)	33,561				33,561
Restricted stock award grants (31,500 shares)	(471)		471		
Exercise of stock options (40,000 shares), including tax benefit	182		551		733
Stock based compensation expense	390				390
Reissue of treasury stock (6,497 shares)	38		88		126
Cash dividends declared ($0.66 per share)		(8,573)			(8,573)
Balance, December 31, 2013	$ 77,923	$ 97,066	$ (633)	$ (9,445)	$ 164,911

See Notes to Consolidated Financial Statements

Table of Contents

Notes to Consolidated Financial Statements

(Dollars in thousands, except per share data)

1. Summary of Significant Accounting Policies

Unless otherwise indicated, dollar amounts are in thousands, except per share data.

Business and Organization

CNB Financial Corporation (the Corporation) is headquartered in Clearfield, Pennsylvania, and provides a full range of banking and related services through its wholly owned subsidiary, CNB Bank (the Bank). In addition, the Bank provides trust and asset management services, including the administration of trusts and estates, retirement plans, and other employee benefit plans as well as a full range of wealth management services. The Bank serves individual and corporate customers and is subject to competition from other financial institutions and intermediaries with respect to these services. In addition to the Bank, the Corporation also operates a consumer discount loan and finance business through its wholly owned subsidiary, Holiday Financial Services Corporation (Holiday). The Corporation and these and its other subsidiaries are subject to examination by federal and state regulators. The Corporation s market area is primarily concentrated in the central and northwest regions of the Commonwealth of Pennsylvania and in the central region of the state of Ohio.

Basis of Financial Presentation

The financial statements are consolidated to include the accounts of the Corporation and the Bank, CNB Securities Corporation, Holiday, County Reinsurance Company, and CNB Insurance Agency. All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements.

Use of Estimates

To prepare financial statements in conformity with accounting principles generally accepted in the U.S., management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ. The allowance for loan losses, carrying value of goodwill, mortgage servicing rights, fair value of assets acquired and liabilities assumed in connection with business combinations and fair values of securities and other financial instruments are particularly subject to change.

Operating Segments

While the chief decision-makers monitor the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Corporation-wide basis, and operating segments are aggregated into one as operating results for all segments are similar. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable operating segment.

Interest Bearing Time Deposits with Other Banks

Interest-bearing deposits in other financial institutions mature within one year and are carried at cost.

Table of Contents

Securities

When purchased, securities are classified as held to maturity, trading or available for sale. Debt securities are classified as held to maturity when the Corporation has the positive intent and ability to hold the securities to maturity. Held to maturity securities are carried at amortized cost. Debt or equity securities are classified as trading when purchased principally for the purpose of selling them in the near term, or when the fair value option has been elected. Trading securities are recorded at fair value with changes in fair value included in earnings in non-interest income. Available for sale securities are those securities not classified as held to maturity or trading and are carried at their fair value. Unrealized gains and losses, net of deferred tax, on securities classified as available for sale are recorded as other comprehensive income. Management has not classified any debt securities as held to maturity.

The amortized cost of debt securities classified as held to maturity or available for sale is adjusted for the amortization of premiums and the accretion of discounts over the period through contractual maturity or, in the case of mortgage-backed securities and collateralized mortgage obligations, over the estimated life of the security. Such amortization is included in interest income from securities. Gains and losses on securities sold are recorded on the trade date and based on the specific identification method.

Declines in the fair value of debt securities below their cost that are other than temporary and attributable to credit losses are reflected in earnings. Other-than-temporary impairment losses that are not attributable to credit losses are reported as a component of accumulated other comprehensive income. In estimating other-than-temporary losses, management considers: the length of time and extent that fair value has been less than cost, the financial condition and near term prospects of the issuer, and the Corporation s intent to sell, or whether it is more likely than not that it will be required to sell a security in an unrealized loss position before recovery of its amortized cost basis. If the Corporation intends to sell a security or it is more likely than not it will be required to sell a security before recovery of its amortized cost basis, the entire difference between amortized cost and fair value is recognized as impairment through earnings.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding.

Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term. Interest income on commercial, industrial, and agricultural loans, commercial mortgage loans, and residential real estate loans is discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection. Consumer loans are typically charged off no later than 180 days past due. Past due status is based on the contractual terms of the loan. Loans, including loans modified in a troubled debt restructuring, are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

All interest accrued but not received on loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. For all portfolio segments, loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Concentration of Credit Risk

Most of the Corporation s business activity is with customers located within the Commonwealth of Pennsylvania and the state of Ohio. Therefore, the Corporation s exposure to credit risk is significantly affected by changes in the economies of Pennsylvania and Ohio.

Purchased Credit Impaired Loans

The Corporation purchased loans in connection with its acquisition of FC Banc Corp. in 2013, some of which have shown evidence of credit deterioration since origination. These purchased credit impaired loans are recorded at the amount paid, such that there is no carryover of the seller s allowance for loan losses. After acquisition, losses are recognized by an increase in the allowance for loan losses.

Such purchased credit impaired loans are accounted for individually, and the Corporation estimates the amount and timing of expected cash flows for each loan. The expected cash flows in excess of the amount paid is recorded as interest income over the remaining life of the loan (accretable yield). The excess of the loan s contractual principal and interest over expected cash flows is not recorded (nonaccretable difference).

Over the life of the loan, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded. If the present value of the expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

For loans purchased that did not show evidence of credit deterioration, the difference between the fair value of the loan at the acquisition date and the loan s face value is being amortized as a yield adjustment over the estimated remaining life of the loan using the effective interest method.

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

Mortgage loans held for sale are generally sold with servicing rights retained. The carrying value of the mortgage loan sold is reduced by the amount allocated to the servicing right. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance account.

Management determines the adequacy of the allowance based on historical patterns of charge-offs and recoveries, the nature and volume of the portfolio, information about specific borrower situations and

Table of Contents

estimated collateral values, industry experience, economic conditions, and other qualitative factors relevant to the collectability of the loan portfolio. While management believes that the allowance is adequate to absorb probable loan losses incurred at the balance sheet date, future adjustments may be necessary due to circumstances that differ substantially from the assumptions used in evaluating the adequacy of the allowance for loan losses.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful. A loan is impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

Commercial and commercial real estate loans are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan s existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures. Troubled debt restructurings are measured at the present value of estimated future cash flows using the loan s effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Corporation determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component of the allowance for loan losses covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Corporation over the most recent 2 years. This actual loss experience is supplemented with other factors based on the risks present for each portfolio segment. These historical loss factors include consideration of the following: levels of and trends in delinquencies, non-accrual loans, and classified loans; trends in volume and terms of loans; effects of any changes in lending policies and procedures; experience, ability, and depth of management; national and local economic trends and conditions; and concentrations of credit.

The following portfolio segments, which are the same as the Corporation s portfolio classifications and associated risk characteristics, have been identified:

Commercial, industrial, and agricultural risk characteristics include recession-like economic conditions in many of the markets served by the Corporation and high levels of unemployment, which has caused consumer spending to slow.
Commercial mortgages the most significant risk characteristic is the subjectivity involved in real estate valuations for properties located in areas with stagnant or low growth economies.
Residential real estate risk characteristics include higher than historical levels of delinquencies and a weakened housing market.
Consumer risk characteristics include continuing weakness in industrial employment in many of the markets served by the Corporation and inflation.
Credit cards the most significant risk characteristic is the unsecured nature of credit card loans.

Table of Contents

Overdrafts risk characteristics include the Corporation s continued deposit growth and overall economic conditions which may lead to a greater likelihood of overdrawn deposit accounts.

Acquired loans were recorded at fair value with no carryover of the related allowance for loan losses. Premiums and discounts recognized on acquired loans are recognized in earnings using the interest method. Credit losses on the acquired loan portfolio will be charged against the allowance for loan losses as incurred.

Federal Home Loan Bank (FHLB) Stock

As a member of the Federal Home Loan Bank of Pittsburgh (FHLB), the Corporation is required to purchase and hold stock in the FHLB to satisfy membership and borrowing requirements. This stock is restricted in that it can only be sold to the FHLB or to another member institution, and all sales of FHLB stock must be at par. As a result of these restrictions, FHLB stock is unlike other investment securities insofar as there is no trading market for FHLB stock and the transfer price is determined by FHLB membership rules and not by market participants.

FHLB stock is held as a long-term investment, is valued at its cost basis and is analyzed for impairment based on the ultimate recoverability of the par value. The Company evaluates impairment quarterly. The decision of whether impairment exists is a matter of judgment that reflects our view of the FHLB s long-term performance, which includes factors such as the following:

- its operating performance;
- the severity and duration of declines in the fair value of its net assets related to its capital stock amount;
- its commitment to make payments required by law or regulation and the level of such payments in relation to its operating performance;
- the impact of legislative and regulatory changes on the FHLB, and accordingly, on the members of FHLB; and
- its liquidity and funding position.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Depreciation of premises and equipment is computed principally by the straight line method. In general, useful lives range from 3 to 39 years with lives for furniture, fixtures and equipment ranging from 3 to 10 years and lives of buildings and building improvements ranging from 15 to 39 years. Amortization of leasehold improvements is computed using the straight-line method over useful lives of the leasehold improvements or the term of the lease, whichever is shorter. Maintenance, repairs and minor renewals are charged to expense as incurred.

Foreclosed Assets

Assets acquired through or in lieu of loan foreclosure are initially recorded at fair value less estimated selling costs when acquired, establishing a new cost basis, and are them carried at the lower of cost or fair value. If fair value declines, a valuation allowance is recorded through expense. Costs after acquisition are expensed.

Bank Owned Life Insurance

The Corporation has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Goodwill and Other Intangible Assets

Goodwill resulting from business combinations prior to January 1, 2009 represents the excess of the purchase price over the fair value of the net assets of businesses acquired. Goodwill resulting from business combinations after January 1, 2009 is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interest in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually or more frequently if events and circumstances exist that indicate an impairment test should be performed.

The Corporation has selected December 31 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives. Goodwill is the only intangible asset with an indefinite life on the Corporation s balance sheet. Other intangible assets consist of a core deposit intangible asset arising from the acquisition of FC Banc Corp. in 2013. The core deposit intangible asset is amortized using an accelerated method over its estimated useful life of 7 years.

Long-term Assets

Premises and equipment, goodwill and other intangible assets, and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Loan Commitments and Related Financial Instruments

Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Derivatives

Derivative financial instruments are recognized as assets or liabilities at fair value. The Corporation has interest rate swap agreements which are used as part of its asset liability management to help manage interest rate risk. The Corporation does not use derivatives for trading purposes.

At the inception of a derivative contract, the Corporation designates the derivative as one of three types based on the purpose of the contract and belief as to its effectiveness as a hedge. These three types are (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (fair value hedge), (2) a hedge of a forecasted transaction or the variability of cash flows to be

Table of Contents

received or paid related to a recognized asset or liability (cash flow hedge), or (3) an instrument with no hedging designation (stand-alone derivative). For a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item, are recognized in current earnings as fair values change. For a cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. For both types of hedges, changes in the fair value of derivatives that are not highly effective in hedging the changes in fair value or expected cash flows of the hedged item are recognized immediately in current earnings. Changes in the fair value of derivatives that do not qualify for hedge accounting are reported currently in earnings, as noninterest income.

Net cash settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged. Net cash settlements on derivatives that do not qualify for hedge accounting are reported in noninterest income. Cash flows on hedges are classified in the cash flow statement the same as the cash flows of the items being hedged.

The Corporation formally documents the relationship between derivatives and hedged items, as well as the risk-management objective and the strategy for undertaking hedge transactions, at the inception of the hedging relationship. This documentation includes linking fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Corporation also formally assesses, both at the hedge s inception and on an ongoing basis, whether the derivative instruments that are used are highly effective in offsetting changes in fair values or cash flows of the hedged items. The Corporation discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative is settled or terminates, a hedged forecasted transaction is no longer probable, a hedged firm commitment is no longer firm, or treatment of the derivative as a hedge is no longer appropriate or intended.

When hedge accounting is discontinued, subsequent changes in fair value of the derivative are recorded as noninterest income. When a fair value hedge is discontinued, the hedged asset or liability is no longer adjusted for changes in fair value and the existing basis adjustment is amortized or accreted over the remaining life of the asset or liability. When a cash flow hedge is discontinued but the hedged cash flows or forecasted transactions are still expected to occur, gains or losses that were accumulated in other comprehensive income are amortized into earnings over the same periods which the hedged transactions will affect earnings.

Advertising Costs

Advertising costs are generally expensed as incurred and amounted to $939, $859, and $822, for 2013, 2012 and 2011 respectively.

Mortgage Servicing Rights

Servicing rights are recognized separately when they are acquired through sales of loans. Servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. The Corporation compares the valuation model inputs and results to published industry data in order to validate the model results and assumptions. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing rights are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Corporation later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income. Changes in valuation allowances are reported with mortgage banking income on the income statement. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Servicing fee income, which is reported on the income statement as mortgage banking income, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal or a fixed amount per loan and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income. Late fees and ancillary fees related to loan servicing are not material.

Treasury Stock

The purchase of the Corporation s common stock is recorded at cost. Purchases of the stock are made both in the open market and through negotiated private purchases based on market prices. At the date of subsequent reissue, the treasury stock account is reduced by the cost of such stock on a first-in-first-out basis.

Stock-Based Compensation

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

At December 31, 2013 and 2012, there was no unrecognized compensation cost related to nonvested stock options granted under this plan, and no stock options were granted during the years then ended.

During 2013, 2012 and 2011, the Executive Compensation and Personnel Committee of the Board of Directors granted a total of 31,500, 26,900 and 17,900 shares, respectively, of restricted common stock to certain key employees and all independent directors of the Corporation. Compensation expense for the restricted stock awards is recognized over the requisite service period based on the fair value of the shares at the date of grant on a straight-line basis. Unearned restricted stock awards are recorded as a

Table of Contents

reduction of shareholders equity until earned. Compensation expense resulting from these restricted stock awards was $390, $277 and $213 for the years ended December 31, 2013, 2012 and 2011, respectively.

Comprehensive Income

The Corporation presents comprehensive income as part of the Consolidated Statement of Income and Comprehensive Income. Other comprehensive income (loss) consists of unrealized holding gains (losses) on the available for sale securities portfolio, changes in the unrecognized actuarial gain and transition obligation related to the Corporation s post retirement benefits plans, and changes in the fair value of the Corporation s interest rate swaps.

Income Taxes

The Corporation files a consolidated U.S. income tax return that includes all subsidiaries except County Reinsurance Company which files a separate return. Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the more likely than not test, no tax benefit is recorded.

The Corporation recognizes interest and/or penalties related to income tax matters in income tax expense.

Retirement Plans

The Corporation s expense associated with its 401(k) plan is determined under the provisions of the plan document and includes both matching and profit sharing components. Deferred compensation and supplemental retirement plan expenses allocate the benefits over years of service.

Earnings Per Share

Basic earnings per share is computed by dividing net income available to common shareholders by the weighted average number of shares outstanding during the applicable period, excluding outstanding participating securities. Diluted earnings per share is computed using the weighted average number of shares determined for the basic computation plus the dilutive effect of potential common shares issuable under certain stock compensation plans. Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are included in the computation of earnings per share pursuant to the two-class method. The Corporation has determined that its outstanding non-vested stock awards are participating securities.

Table of Contents

Cash and Cash Equivalents

For purposes of the consolidated statement of cash flows, the Corporation defines cash and cash equivalents as cash and due from banks, interest bearing deposits with other banks, and Federal funds sold. Net cash flows are reported for customer loan and deposit transactions, interest bearing time deposits with other banks and borrowings with original maturities of 90 days or less.

Restrictions on Cash

The Bank is required to maintain average reserve balances with the Federal Reserve Bank or in vault cash. The average amount of these non-interest bearing reserve balances for the year ended December 31, 2013 and 2012, was $50, which was maintained in vault cash. Note 12 to the consolidated financial statements discloses the cash collateral balances required to be maintained in connection with the Corporation s interest rate swaps.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are any such matters that will have a material effect on the financial statements.

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Adoption of New Accounting Standards

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

In July 2013, the FASB issued Accounting Standards Update 2013-10, Derivatives and Hedging (Topic 815), Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes (ASU 2013-10). ASU 2013-10 was issued to permit the Fed Funds Effective Swap Rate to be used as a U.S. benchmark interest rate for hedge accounting

Table of Contents

purposes under Topic 815, in addition to direct Treasury obligations of the U.S. Government and the London Interbank Offered Rate (LIBOR) swap rate. ASU 2013-10 is effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The adoption of ASU 2013-10 did not have a material effect on the Corporation s financial statements.

Effect of Newly Issued But Not Yet Effective Accounting Standards

In February 2013, the FASB issued Accounting Standards Update 2013-04, Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date (ASU 2013-04). ASU 2013-04 provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of the guidance is fixed at the reporting date, except for obligations addressed within existing guidance in U.S. GAAP. ASU 2013-04 is effective for reporting periods beginning after December 15, 2013. The effect of adopting ASU 2013-04 is not expected to have a material effect on the Corporation s financial statements.

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

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

Reclassifications

Certain prior year amounts have been reclassified for comparative purposes.

2. Business Combination

In the first quarter of 2013, the Corporation announced the signing of a definitive merger agreement to acquire 100% of the outstanding equity interests of FC Banc Corp. and its subsidiary, Farmers Citizens Bank, for $30.00 per share in cash and stock. Farmers Citizens Bank served the central Ohio markets of Bucyrus, Cardington, Fredericktown, Mount Hope and Shiloh, as well as the markets of Worthington and Upper Arlington in the greater Columbus, Ohio area, with 8 branch locations. The transaction closed on October 11, 2013 and resulted in consideration paid to FC Banc Corp. shareholders totaling approximately $41.6 million, comprised of approximately $8.0 million in cash and 1,873,879 shares of the Corporation s common stock valued at approximately $33.6 million based on the October 11, 2013 closing price of $17.91 per share. FC Banc Corp. results of operations were included in the Corporation s results beginning October 12, 2013.

Table of Contents

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

As disclosed in the accompanying consolidated statements of income, the Corporation incurred merger costs of $2,396 during the year ended December 31, 2013. All merger costs have been expensed as incurred.

The following table summarizes the consideration paid for FC Banc Corp. and the amounts of the assets acquired and liabilities assumed that were recognized at the acquisition date:

Consideration paid:	
Cash	$ 8,013
Common stock	33,561
Fair value of total consideration transferred	41,574
Recognized amounts of identifiable assets acquired and liabilities assumed:	
Cash and cash equivalents	54,995
Securities available for sale	34,214
Loans	247,737
FHLB and other equity interests	1,789
Premises and equipment	4,328
Bank owned life insurance	3,955
Mortgage servicing rights	83
Core deposit intangible	4,834
Accrued interest receivable and other assets	8,093
Total assets acquired	360,028
Demand deposits	248,812
Time deposits	83,214
Accrued interest payable and other liabilities	2,676
Total liabilities assumed	334,702
Total identifiable net assets	25,326
Goodwill	$ 16,248

Included in accrued interest receivable and other assets is a deferred tax asset totaling $5,696 representing the tax effect of temporary differences between the tax basis and fair values assigned to the assets and liabilities, as well as the effect of FC Banc Corp. s net operating loss carryfowards. See Note 13.

Acquired loans were recorded at fair value with no carryover of the related allowance for loan losses. Determining the fair value of loans involved estimating the amount and timing of principal and interest cash flows expected to be collected on the loans and discounting those cash flows at a market rate of interest. Loans acquired with evidence of credit quality deterioration totaled $2,225. The Corporation acquired $256,418 of gross loans, including purchased credit impaired loans, and recognized a net combined yield and credit mark of $8,681.

Table of Contents

Goodwill of $16,248 arising from the acquisition consisted largely of synergies and the cost savings resulting from the combining of the operations of the Corporation and FC Banc Corp. None of the goodwill is expected to be deductible for income tax purposes.

The following table presents pro forma information as if the acquisition had occurred at the beginning of 2012:

	2013	2012
Net interest income	$ 68,723	$ 65,786
Net income	17,589	20,125
Basic earnings per share	1.23	1.41
Diluted earnings per share	1.23	1.41

3. Earnings Per Share

The computation of basic and diluted earnings per share is shown below (in thousands, except per share data). For the years ended December 31, 2012, and 2011, options to purchase 37,500 and 75,500 shares of common stock were not considered in computing diluted earnings per share because they were anti-dilutive. There were no anti-dilutive stock options for the year ended December 31, 2013.

	Years Ended December 31		
	2013	2012	2011
Basic earnings per common share computation			
Net income per consolidated statements of income	$ 16,679	$ 17,136	$ 15,104
Net earnings allocated to participating securities	(73)	(62)	(42)
Net earnings allocated to common stock	$ 16,606	$ 17,074	$ 15,062
Distributed earnings allocated to common stock	$ 8,532	$ 8,182	$ 8,101
Undistributed earnings allocated to common stock	8,074	8,892	6,961
Net earnings allocated to common stock	$ 16,606	$ 17,074	$ 15,062
Weighted average common shares outstanding, including shares considered participating securities	12,929	12,441	12,306
Less: Average participating securities	(50)	(41)	(33)
Weighted average shares	12,879	12,400	12,273
Basic earnings per common share	$ 1.29	$ 1.38	$ 1.23
Diluted earnings per common share computation			
Net earnings allocated to common stock	$ 16,606	$ 17,074	$ 15,062
Weighted average common shares outstanding for basic earnings per common share	12,879	12,400	12,273
Add: Dilutive effects of assumed exercises of stock options	2	3	6
Weighted average shares and dilutive potential common shares	12,881	12,403	12,279
Diluted earnings per common share	$ 1.29	$ 1.38	$ 1.23

65

Table of Contents

4. Securities

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

	December 31, 2013				December 31, 2012			
	Amortized	Unrealized		Fair	Amortized	Unrealized		Fair
	Cost	Gains	Losses	Value	Cost	Gains	Losses	Value
U.S. Treasury	$ 0	$ 0	$ 0	$ 0	$ 4,018	$ 18	$ 0	$4,036
U.S. Gov t sponsored entities	185,205	2,894	(6,474)	181,625	157,965	5,977	(161)	163,781
State & political subdivisions	176,490	3,770	(2,317)	177,943	170,223	11,113	(57)	181,279
Residential & multi-family mortgage	248,017	2,410	(7,820)	242,607	308,800	8,724	(702)	316,822
Commercial mortgage	385	0	(11)	374	1,275	29	0	1,304
Corporate notes & bonds	15,744	65	(1,734)	14,075	17,368	26	(2,370)	15,024
Pooled trust preferred	800	0	(139)	661	800	0	(200)	600
Pooled SBA	70,077	688	(3,044)	67,721	50,667	2,277	(17)	52,927
Other securities	1,020	0	(35)	985	1,521	17	0	1,538
Total	$697,738	$9,827	$(21,574)	$685,991	$712,637	$28,181	$(3,507)	$737,311

At December 31, 2013 and 2012, there were no holdings of securities by any one issuer, other than U.S. Government sponsored entities, in an amount greater than 10% of shareholders equity. The Corporation s residential and multi-family mortgage securities are issued by government sponsored entities, and the Corporation holds one commercial mortgage security that is private label.

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

	2013	2012
Corporate equity securities	$ 2,705	$ 3,117
Certificates of deposit	253	408
International mutual funds	259	287
Large cap growth mutual funds	197	157
Money market mutual funds	124	110
Large cap value mutual funds	129	104
Corporate notes and bonds	152	101
Real estate investment trust mutual funds	39	65
U.S. Government sponsored entities	52	58
Small cap mutual funds	83	26
Mid cap mutual funds	84	26
Commodities mutual funds	50	0
Total	$ 4,127	$ 4,459

Table of Contents

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

December 31, 2013	**Less than 12 Months**		**12 Months or More**		**Total**	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
Description of Securities	Value	Loss	Value	Loss	Value	Loss
U.S. Treasury	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
U.S. Gov t sponsored entities	95,677	(5,394)	17,964	(1,080)	113,641	(6,474)
State & political subdivisions	57,526	(2,192)	5,324	(125)	62,850	(2,317)
Residential & multi-family mortgage	150,229	(6,806)	16,608	(1,014)	166,837	(7,820)
Commercial mortgage	374	(11)	0	0	374	(11)
Corporate notes & bonds	0	0	9,662	(1,734)	9,662	(1,734)
Pooled trust preferred	0	0	661	(139)	661	(139)
Pooled SBA	36,842	(2,296)	8,277	(748)	45,119	(3,044)
Other securities	985	(35)	0	0	985	(35)
	$ 341,633	$ (16,734)	$ 58,496	$ (4,840)	$ 400,129	$ (21,574)

	Less than 12 Months		**12 Months or More**		**Total**	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
December 31, 2012						
U.S. Treasury	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
U.S. Gov t sponsored entities	41,715	(161)	0	0	41,715	(161)
State & political subdivisions	7,857	(57)	0	0	7,857	(57)
Residential and multi-family mortgage	32,159	(688)	4,254	(14)	36,413	(702)
Commercial mortgage	0	0	0	0	0	0
Corporate notes & bonds	0	0	13,002	(2,370)	13,002	(2,370)
Pooled trust preferred	0	0	600	(200)	600	(200)
Pooled SBA	3,521	(17)	0	0	3,521	(17)
Other securities	0	0	0	0	0	0
	$ 85,252	$ (923)	$ 17,856	$ (2,584)	$ 103,108	$ (3,507)

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

The following table provides detailed information related to the Corporation s structured pooled trust preferred securities as of December 31, 2013 and for the years ended December 31, 2013, 2012, and 2011:

	As of December 31, 2013			Credit Losses Realized in Earnings		
	Adjusted Amortized Cost	Unrealized Gain (Loss)	Fair Value	Year Ended December 31, 2013	2012	2011
ALESCO Preferred Funding V, Ltd.	$ 800	$ (139)	$ 661	$ 0	$ 0	$ 0
ALESCO Preferred Funding XII, Ltd.	0	0	0	0	0	280
ALESCO Preferred Funding XVII, Ltd.	0	0	0	0	0	0

Preferred Term Securities XVI, Ltd.	0	0	0	0	0	118
US Capital Funding VI, Ltd.	0	0	0	0	0	0
Total	$ 800	$ (139)	$ 661	$ 0	$ 0	$ 398

Table of Contents

At December 31, 2013, the Corporation evaluated the ALESCO Preferred Funding V, Ltd. Security for other than-temporary impairment by estimating the cash flows expected to be received, taking into account future estimated levels of deferrals and defaults by the underlying issuers and discounting those cash flows at the appropriate accounting yield.

A roll-forward of the other-than-temporary impairment amount related to credit losses for the years ended December 31, 2013, 2012 and 2011 is as follows:

	2013	2012	2011
Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in earnings, beginning of period	$ 4,054	$ 4,054	$ 3,656
Additional credit loss for which other-than-temporary impairment was not previously recognized	0	0	0
Additional credit loss for which other-than-temporary impairment was previously recognized	0	0	398
Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in earnings, end of period	$ 4,054	$ 4,054	$ 4,054

Due to the insignificance of the adjusted amortized cost of structured pooled trust preferred securities as of December 31, 2013 and 2012, no further disclosures are required.

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

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

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

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

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

On December 31, 2013 and 2012, securities carried at $353,102 and $264,813, respectively, were pledged to secure public deposits and for other purposes as provided by law.

Table of Contents

The following is a schedule of the contractual maturity of securities available for sale, excluding equity securities, at December 31, 2013:

	December 31, 2013	
	Amortized Cost	Fair Value
1 year or less	$ 31,192	$ 30,902
1 year 5 years	141,228	141,410
5 years 10 years	165,713	163,735
After 10 years	40,106	38,257
	378,239	374,304
Residential and multi-family mortgage	248,017	242,607
Pooled SBA	70,077	67,721
Commercial mortgage	385	374
Total debt securities	$ 696,718	$ 685,006

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

Information pertaining to security sales is as follows:

Year ended December 31	Proceeds	Gross Gains	Gross Losses
2013	$ 35,633	$ 849	$ 494
2012	125,579	1,809	430
2011	69,740	878	264

The tax provision related to these net realized gains was $124, $483, and $215, respectively.

During 2013, 2012 and 2011, the Corporation sold trading securities. Proceeds were $5,811 in 2013, $3,386 in 2012, and $343 in 2011, resulting in net gains of $579 in 2013, $298 in 2012, and $30 in 2011.

5. Loans

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

	2013	2012
Commercial, industrial, and agricultural	$ 291,704	$ 257,091
Commercial mortgages	467,292	261,791
Residential real estate	471,298	347,904
Consumer	63,491	58,668
Credit cards	5,065	4,800
Overdrafts	409	971
Less: unearned discount	(3,896)	(3,401)
allowance for loan losses	(16,234)	(14,060)
Loans, net	$ 1,279,129	$ 913,764

At December 31, 2013 and 2012 net unamortized loan costs of $911 and $232, respectively, have been included in the carrying value of loans.

The Corporation s outstanding loans and related unfunded commitments are primarily concentrated within Central and Western Pennsylvania and Central Ohio. The Bank attempts to limit concentrations within specific industries by utilizing dollar limitations to single industries or customers, and by entering into participation agreements with third parties. Collateral requirements are established based on management s assessment of the customer. The Corporation maintains lending policies to control the quality of the loan portfolio. These policies delegate the authority to extend loans under specific guidelines and underwriting standards. These policies are prepared by the Corporation s management and reviewed and ratified annually by the Corporation s Board of Directors.

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

Commercial, industrial, and agricultural loans comprised 23% and 28% of the Corporation s total loan portfolio at December 31, 2013 and 2012, respectively. Commercial mortgage loans comprised 37% and 29% of the Corporation s total loan portfolio at December 31, 2013 and 2012, respectively. Management assigns a risk rating to all commercial loans in excess of $250,000. The loan-to-value policy guidelines for commercial, industrial, and agricultural loans are generally a maximum of 80% of the value of business equipment, a maximum of 75% of the value of accounts receivable, and a maximum of 60% of the value of business inventory. The loan-to-value policy guideline for commercial mortgage loans is generally a maximum of 85% of the appraised value of the real estate.

Residential real estate loans comprised 37% and 38% of the Corporation s total loan portfolio at December 31, 2013 and 2012, respectively. The loan-to-value policy guidelines for residential real estate loans vary depending on the collateral position and the specific type of loan. Higher loan-to-value terms may be approved with the appropriate private mortgage insurance coverage. The Corporation also originates and prices loans for sale into the secondary market through Freddie Mac. Loans so originated are classified as loans held for sale and are excluded from residential real estate loans reported above. The rationale for these sales is to mitigate interest rate risk associated with holding lower rate, long-term residential mortgages in the loan portfolio and to generate fee revenue from sales and servicing the loan. The Corporation also offers a variety of unsecured and secured consumer loan and credit card products which represent less than 10% of the total loan portfolio at both December 31, 2013 and 2012. Terms and collateral requirements vary depending on the size and nature of the loan.

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

Table of Contents

Transactions in the allowance for loan losses for the year ended December 31, 2013 were as follows:

	Commercial, Industrial, and Agricultural	Commercial Mortgages	Residential Real Estate	Consumer	Credit Cards	Overdrafts	Total
Allowance for loan losses, January 1, 2013	$ 4,940	$ 4,697	$ 2,466	$ 1,699	$ 83	$ 175	$ 14,060
Charge-offs	(958)	(1,931)	(467)	(1,919)	(97)	(258)	(5,630)
Recoveries	7	1,430	5	114	16	94	1,666
Provision for loan losses	2,290	1,273	876	1,439	64	196	6,138
Allowance for loan losses, December 31, 2013	$ 6,279	$ 5,469	$ 2,880	$ 1,333	$ 66	$ 207	$ 16,234

Transactions in the allowance for loan losses for the year ended December 31, 2012 were as follows:

	Commercial, Industrial, and Agricultural	Commercial Mortgages	Residential Real Estate	Consumer	Credit Cards	Overdrafts	Total
Allowance for loan losses, January 1, 2012	$ 4,511	$ 4,470	$ 1,991	$ 1,404	$ 71	$ 168	$ 12,615
Charge-offs	(2,871)	(401)	(304)	(1,279)	(78)	(257)	(5,190)
Recoveries	45	0	1	91	18	99	254
Provision for loan losses	3,255	628	778	1,483	72	165	6,381
Allowance for loan losses, December 31, 2012	$ 4,940	$ 4,697	$ 2,466	$ 1,699	$ 83	$ 175	$ 14,060

Transactions in the allowance for loan losses for the year ended December 31, 2011 were as follows:

	Commercial, Industrial, and Agricultural	Commercial Mortgages	Residential Real Estate	Consumer	Credit Cards	Overdrafts	Total
Allowance for loan losses, January 1, 2011	$ 3,517	$ 3,511	$ 1,916	$ 1,561	$ 96	$ 219	$ 10,820
Charge-offs	(1,796)	(175)	(217)	(907)	(39)	(222)	(3,356)
Recoveries	9	0	13	88	10	94	214
Provision for loan losses	2,781	1,134	279	662	4	77	4,937
Allowance for loan losses, December 31, 2011	$ 4,511	$ 4,470	$ 1,991	$ 1,404	$ 71	$ 168	$ 12,615

Table of Contents

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

December 31, 2013	Commercial, Industrial, and Agricultural	Commercial Mortgages	Residential Real Estate	Consumer	Credit Cards	Overdrafts	Total
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$ 372	$ 55	$ 0	$ 0	$ 0	$ 0	$ 427
Collectively evaluated for impairment	5,907	3,959	2,880	1,333	66	207	14,352
Acquired with deteriorated credit quality	0	0	0	0	0	0	0
Modified in a troubled debt restructuring	0	1,455	0	0	0	0	1,455
Total ending allowance balance	$ 6,279	$ 5,469	$ 2,880	$ 1,333	$ 66	$ 207	$ 16,234
Loans:							
Individually evaluated for impairment	$ 4,923	$ 1,249	$ 0	$ 0	$ 0	$ 0	$ 6,172
Collectively evaluated for impairment	285,518	452,945	471,298	63,491	5,065	409	1,278,726
Acquired with deteriorated credit quality	0	2,225	0	0	0	0	2,225
Modified in a troubled debt restructuring	1,263	10,873	0	0	0	0	12,136
Total ending loans balance	$ 291,704	$ 467,292	$ 471,298	$ 63,491	$ 5,065	$ 409	$ 1,299,259

December 31, 2012	Commercial, Industrial, and Agricultural	Commercial Mortgages	Residential Real Estate	Consumer	Credit Cards	Overdrafts	Total
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$ 541	$ 131	$ 81	$ 0	$ 0	$ 0	$ 753
Collectively evaluated for impairment	4,399	3,467	2,385	1,699	83	175	12,208
Modified in a troubled debt restructuring	0	1,099	0	0	0	0	1,099
Total ending allowance balance	$ 4,940	$ 4,697	$ 2,466	$ 1,699	$ 83	$ 175	$ 14,060
Loans:							
Individually evaluated for impairment	$ 2,623	$ 10,683	$ 593	$ 0	$ 0	$ 0	$ 13,899
Collectively evaluated for impairment	253,048	240,907	347,311	58,668	4,800	971	905,705
Modified in a troubled debt restructuring	1,420	10,201	0	0	0	0	11,621
Total ending loans balance	$ 257,091	$ 261,791	$ 347,904	$ 58,668	$ 4,800	$ 971	$ 931,225

Table of Contents

The following tables present information related to loans individually evaluated for impairment, including loans modified in troubled debt restructurings, by portfolio segment as of December 31, 2013 and 2012 and for the years ended December 31, 2013, 2012, and 2011:

December 31, 2013	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
With an allowance recorded:			
Commercial, industrial, and agricultural	$ 5,402	$ 4,152	$ 372
Commercial mortgage	6,173	5,970	1,510
Residential real estate	0	0	0
With no related allowance recorded:			
Commercial, industrial, and agricultural	2,055	2,034	0
Commercial mortgage	6,178	6,152	0
Residential real estate	0	0	0
Total	$ 19,808	$ 18,308	$ 1,882

December 31, 2012	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
With an allowance recorded:			
Commercial, industrial, and agricultural	$ 2,542	$ 1,792	$ 541
Commercial mortgage	5,870	5,329	1,230
Residential real estate	416	381	81
With no related allowance recorded:			
Commercial, industrial, and agricultural	2,804	2,251	0
Commercial mortgage	17,285	15,555	0
Residential real estate	308	212	0
Total	$ 29,225	$ 25,520	$ 1,852

The unpaid principal balance of impaired loans includes the Corporation s recorded investment in the loan and amounts that have been charged off.

	Year Ended December 31, 2013		
	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With an allowance recorded:			
Commercial, industrial, and agricultural	$ 1,989	$ 7	$ 7

Commercial mortgage	6,572	3	3
Residential real estate	101	7	7
With no related allowance recorded:			
Commercial, industrial, and agricultural	2,124	0	0
Commercial mortgage	11,885	0	0
Residential real estate	86	0	0
Total	$ 22,757	$ 17	$ 17

Table of Contents

	Year Ended December 31, 2012 Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With an allowance recorded:			
Commercial, industrial, and agricultural	$ 3,083	$ 4	$ 4
Commercial mortgage	5,504	3	3
Residential real estate	334	13	13
With no related allowance recorded:			
Commercial, industrial, and agricultural	3,217	0	0
Commercial mortgage	12,723	0	0
Residential real estate	103	0	0
Total	$ 24,964	$ 20	$ 20

	Year Ended December 31, 2011 Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With an allowance recorded:			
Commercial, industrial, and agricultural	$ 3,711	$ 3	$ 3
Commercial mortgage	6,412	19	19
Residential real estate	179	4	4
With no related allowance recorded:			
Commercial, industrial, and agricultural	2,050	0	0
Commercial mortgage	6,040	0	0
Residential real estate	0	0	0
Total	$ 18,392	$ 26	$ 26

The following table presents the recorded investment in nonaccrual loans and loans past due over 90 days still on accrual by class of loans as of December 31, 2012 and 2011:

	December 31, 2013		December 31, 2012	
	Nonaccrual	Past Due Over 90 Days Still on Accrual	Nonaccrual	Past Due Over 90 Days Still on Accrual
Commercial, industrial, and agricultural	$ 1,006	$ 0	$ 3,073	$ 0
Commercial mortgages	7,236	0	8,570	109
Residential real estate	2,389	150	2,792	18
Consumer	942	170	10	217
Credit cards	0	24	0	13

Total	$ 11,573	$ 344	$ 14,445	$ 357

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

Table of Contents

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

December 31, 2013	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial, industrial, and agricultural	$ 211	$ 542	$ 855	$ 1,608	$ 290,096	$ 291,704
Commercial mortgages	1,258	713	7,236	9,207	458,085	467,292
Residential real estate	4,216	114	2,539	6,869	464,429	471,298
Consumer	334	1,049	1,112	2,495	60,996	63,491
Credit cards	0	29	24	53	5,012	5,065
Overdrafts	0	0	0	0	409	409
Total	$ 6,019	$ 2,447	$ 11,766	$ 20,232	$ 1,279,027	$ 1,299,259

December 31, 2012	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial, industrial, and agricultural	$ 724	$ 157	$ 2,968	$ 3,849	$ 253,242	$ 257,091
Commercial mortgages	1,162	3,197	8,679	13,038	248,753	261,791
Residential real estate	1,390	641	2,700	4,731	343,173	347,904
Consumer	724	203	227	1,154	57,514	58,668
Credit cards	39	9	13	61	4,739	4,800
Overdrafts	0	0	0	0	971	971
Total	$ 4,039	$ 4,207	$ 14,587	$ 22,833	$ 908,392	$ 931,225

Troubled Debt Restructurings

During the years ended December 31, 2013 and 2012, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included either or both of the following: a reduction of the stated interest rate of the loan; or an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk.

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

	December 31, 2013			December 31, 2012		
	Number of Loans	Loan Balance	Specific Reserve	Number of Loans	Loan Balance	Specific Reserve
Commercial, industrial, and agricultural	2	$ 1,263	$ 0	2	$ 1,420	$ 0
Commercial mortgages	10	10,873	1,455	8	10,201	1,099
Residential real estate	0	0	0	0	0	0
Consumer	0	0	0	0	0	0
Credit cards	0	0	0	0	0	0
Total	12	$ 12,136	$ 1,455	10	$ 11,621	$ 1,099

Table of Contents

The following table presents loans by class modified as troubled debt restructurings that occurred during the years ended December 31, 2013 and 2012:

	Year Ended December 31, 2013		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial, industrial, and agricultural	0	$ 0	$ 0
Commercial mortgages	3	3,747	3,681
Residential real estate	0	0	0
Consumer	0	0	0
Credit cards	0	0	0
Total	3	$ 3,747	$ 3,681

	Year Ended December 31, 2012		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial, industrial, and agricultural	2	$ 1,455	$ 1,455
Commercial mortgages	5	2,717	2,717
Residential real estate	0	0	0
Consumer	0	0	0
Credit cards	0	0	0
Total	7	$ 4,172	$ 4,172

The troubled debt restructurings described above increased the allowance for loan losses by $514 and $101 during the years ended December 31, 2013 and 2012, respectively.

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

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms. Except as discussed below, all loans modified in troubled debt restructurings are performing in accordance with their modified terms as of December 31, 2013 and 2012 and no principal balances were forgiven in connection with the loan restructurings.

During the year ended December 31, 2013, the Corporation recorded a partial charge-off of $974 for a commercial mortgage loan with a balance of $1,660 that had defaulted under its restructured terms in 2012 and was placed on nonaccrual status. The Corporation recorded an additional provision for loan losses of $262 on this loan during the year ended December 31, 2013. A commercial mortgage loan with a balance of $1,086 defaulted under its restructured terms in 2013 and was placed on nonaccrual status. The Corporation recorded an additional provision for loan losses of $615 during the year ended December 31, 2013. In addition, an impaired commercial mortgage loan that was placed on non-accrual status in 2013 and having a balance of $3,269 was modified in a troubled debt restructuring. The Corporation recorded an additional provision for loan losses of $514 for this loan during the year ended December 31, 2013.

Table of Contents

During the year ended December 31, 2012, one commercial mortgage loan with a balance of $1,660 defaulted under its restructured terms and was placed on nonaccrual status, resulting in an increase in the allowance for loan losses of $503. No loans that were modified in a troubled debt restructuring were charged off during the year ended December 31, 2012.

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

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

Credit Quality Indicators

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

The Corporation uses the following definitions for risk ratings:

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

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

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

Table of Contents

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

December 31, 2013	Pass	Special Mention	Substandard	Doubtful	Total
Commercial, industrial, and agricultural	$ 266,868	$ 5,377	$ 19,318	$ 141	$ 291,704
Commercial mortgages	404,876	16,755	44,936	725	467,292
Total	$ 671,744	$ 22,132	$ 64,254	$ 866	$ 758,996

December 31, 2012	Pass	Special Mention	Substandard	Doubtful	Total
Commercial, industrial, and agricultural	$ 234,835	$ 6,641	$ 15,459	$ 156	$ 257,091
Commercial mortgages	225,294	12,294	23,501	702	261,791
Total	$ 460,129	$ 18,935	$ 38,960	$ 858	$ 518,882

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

	December 31, 2013			December 31, 2012		
	Residential Real Estate	Consumer	Credit Cards	Residential Real Estate	Consumer	Credit Cards
Performing	$ 468,759	$ 62,379	$ 5,041	$ 345,094	$ 58,441	$ 4,787
Non-performing	2,539	1,112	24	2,810	227	13
Total	$ 471,298	$ 63,491	$ 5,065	$ 347,904	$ 58,668	$ 4,800

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

Holiday s loan portfolio, included in consumer and residential loans above, is summarized as follows at December 31, 2013 and 2012:

	2013	2012
Consumer	$ 24,891	$ 21,535
Residential real estate	1,552	954
Less: unearned discount	(3,896)	(3,401)
Total	$ 22,547	$ 19,088

Table of Contents

6. Secondary Market Mortgage Activities

The following summarizes secondary market mortgage activities for the years ended December 31, 2013, 2012, and 2011:

	2013	2012	2011
Loans originated for resale, net of principal pay downs	$ 19,883	$ 32,626	$ 19,927
Proceeds from sales of loans held for sale	22,252	32,512	23,324
Net gains on sales of loans held for sale	808	927	638
Loan servicing fees	375	340	349

Total loans serviced for others was $114,428, $104,017, and $109,006 at December 31, 2013, 2012, and 2011, respectively.

The following summarizes activity for capitalized mortgage servicing rights for the years ended December 31, 2013, 2012, and 2011:

	2013	2012	2011
Balance, beginning of year	$ 714	$ 906	$ 909
Additions	350	85	249
Servicing rights acquired	83	0	0
Amortization	(242)	(277)	(252)
Balance, end of year	$ 905	$ 714	$ 906

The fair value of mortgage servicing rights is based on market prices for comparable mortgage servicing contracts, when available, or alternatively based on a valuation model that calculates the present value of estimated future net servicing income. The fair value of mortgage servicing rights was $915, $718, and $959 at December 31, 2013, 2012, and 2011, respectively. No valuation allowance is deemed necessary at December 31, 2013, 2012, or 2011. The fair value of interest rate lock commitments was not material at December 31, 2013 or 2012.

7. Premises and Equipment

The following summarizes premises and equipment at December 31, 2013 and 2012:

	2013	2012
Land	$ 4,412	$ 4,126
Premises and leasehold improvements	28,764	25,670
Furniture and equipment	20,248	17,522
Construction in process	3,924	408
	57,348	47,726
Less: accumulated depreciation	25,759	23,654
Premises and equipment, net	$ 31,589	$ 24,072

Depreciation on premises and equipment amounted to $2,147 in 2013, $1,948 in 2012, and $1,823 in 2011.

79

Table of Contents

In 2013, the Corporation entered into a contractual commitment to expand its main office facility in Clearfield, Pennsylvania at a cost of $4,128. Construction has commenced with $3,112 in construction-related expenditures incurred as of December 31, 2013. The project is expected to be completed early in the second quarter of 2014.

The Corporation is committed under twenty noncancelable operating leases for facilities and four noncancelable operating leases for vehicles with initial or remaining terms in excess of one year. The minimum annual rental commitments under these leases at December 31, 2013 are as follows:

2014	$	630
2015		617
2016		592
2017		426
2018		207
Thereafter		1,169
	$	3,641

Rental expense, net of rental income, charged to occupancy expense for 2013, 2012, and 2011 was $490, $351, and $349, respectively.

In December 2009, the Corporation entered into a sale-leaseback transaction for real estate used in the operations of one of its branch office locations. The lease term is seventeen years, with two automatic renewal terms of five years each. The Corporation sold the property for $1,200 but financed the entire sales amount. Because the buyer/lessor did not make an initial investment on the purchase of the real estate that is adequate to transfer the risks and rewards of ownership, the Corporation deferred the entire gain of $489 associated with this transaction, which is included in accrued interest payable and other liabilities in the accompanying consolidated balance sheet. The gain is being recognized over the term of the loan under the installment method, and the gain recognized was included in other income in the accompanying consolidated statements of income and comprehensive income and totaled $17, $19, and $16 in 2013, 2012, and 2011, respectively.

The minimum annual rental commitments under this lease at December 31, 2013 are as follows:

2014	$	112
2015		112
2016		112
2017		112
2018		112
Thereafter		893
	$	1,453

Table of Contents

8. Foreclosed Assets

Foreclosed real estate is reported net of a valuation allowance and included in accrued interest receivable and other assets in the accompanying consolidated balance sheets. Activity for the years ended December 31, 2013, 2012, and 2011 is as follows:

	2013	2012	2011
Balance, beginning of year	$ 325	$ 505	$ 396
Additions	1,151	750	249
Sales (at carrying value)	(490)	(930)	(140)
Balance, end of year	$ 986	$ 325	$ 505

Expenses related to foreclosed real estate include:

	2013	2012	2011
Net loss (gain) on sale	$ (252)	$ (158)	$ (101)
Operating expenses, net of rental income	81	176	24
	$ (171)	$ 18	$ (77)

9. Goodwill and Intangible Assets

Goodwill

The change in the carrying amount of goodwill for the years ended December 31, 2013 and 2012 is as follows:

	2013	2012
Balance, beginning of year	$ 10,946	$ 10,821
Acquired during the year	16,248	125
Balance, end of year	$ 27,194	$ 10,946

The goodwill acquired in 2013 is attributable to the business combination associated with the Corporation s acquisition of FC Banc Corp. (Note 2).

In 2012, the Corporation purchased the loans and other assets of a consumer discount company in Ebensburg, Pennsylvania. The purchase price was $1,248 for the performing loans and customers of the business. The purchase price resulted in the Corporation recording goodwill of $125 in connection with the acquisition. Due to the insignificance of the assets acquired in relation to the consolidated financial statements as a whole, no further business combination or intangible asset disclosures are included in the notes to consolidated financial statements.

Impairment exists when a reporting unit s carrying value of goodwill exceeds its fair value, which is determined through a two-step impairment test. Step 1 includes the determination of the carrying value of our single reporting unit, including the existing goodwill and intangible assets, and estimating the

81

Table of Contents

fair value of the reporting unit. We determined the fair value of our reporting unit exceeded its carrying amount. If the carrying amount of the reporting unit exceeds its fair value, we are required to perform a second step to the impairment test. Our annual impairment analysis at December 31, 2013 and 2012 indicated that the Step 2 analysis was not necessary.

Intangible Assets

In connection with its acquisition of FC Banc Corp. in 2013, the Corporation recorded a core deposit intangible asset of $4,834 and amortization expense of $251, resulting in a net carrying value of $4,583 at December 31, 2013. No other intangible assets were required to be recorded in connection with the acquisition.

Estimated amortization expense for each of the next five years is as follows:

2014	$	1,180
2015		1,007
2016		835
2017		662
2018		489

10. Deposits

The following table reflects time certificates of deposit accounts included in total deposits and their remaining maturities at December 31, 2013:

Time deposits maturing:		
2014	$	122,126
2015		43,106
2016		40,874
2017		20,608
2018		27,043
Thereafter		12,005
	$	265,762

Certificates of deposit of $100 thousand or more totaled $126,924 and $87,018 at December 31, 2013 and 2012, respectively.

11. Borrowings

At December 31, 2013, the Corporation had available one $10 million line of credit with an unaffiliated institution, at a variable interest rate with a floor as defined in the agreement. At December 31, 2012, the Corporation had available one $9 million line of credit with an unaffiliated institution, which was not renewed in 2013. There were no borrowings on either line of credit at December 31, 2013 and 2012.

Table of Contents

FHLB Borrowings

At December 31, 2013, the Bank had remaining borrowing capacity with the FHLB of $348,574. At December 31, 2013, borrowings with the FHLB are secured by a pledge of selected securities in the amount of $75,885 and certain loans with a balance of $469,822 at December 31, 2013. Borrowings from the FHLB at December 31, 2013 and 2012 are as follows:

Interest Rate	Maturity	2013	2012
(a)	09/17/15	$ 20,000	$ 20,000
(b)	06/01/17	10,000	10,000
(c)	08/07/17	5,000	5,000
(d)	08/07/17	5,000	5,000
(e)	08/07/17	10,000	10,000
(f)	10/10/17	10,000	10,000
(g)	07/07/23	700	700
(h)	09/05/23	2,280	2,388
(i)	06/11/24	535	557
(j)	05/24/26	302	321
(k)	10/14/26	311	330
(l)	02/11/33	872	0
		$ 65,000	$ 64,296

(a), (g) Fixed rate borrowings at interest rates of 2.09% and 4.72%, respectively.

(b) Interest rate was fixed at 4.60% until June 2009, since which time FHLB has had the option to convert to floating interest rate based on the 3 month LIBOR + 0.16%. The interest rate was 4.60% at December 31, 2013 and 2012.

(c) Interest rate was fixed at 4.02% until February 2008, since which time FHLB has had the option to convert to a floating interest rate based on the 3 month LIBOR + 0.11%. The interest rate was 4.02% at December 31, 2013 and 2012.

(d) Interest rate was fixed at 4.10% until August 2008, since which time FHLB has had the option to convert to a floating interest rate based on the 3 month LIBOR + 0.11%. The interest rate was 4.10% at December 31, 2013 and 2012.

(e) Interest rate is fixed at 4.47% until August 2010, since which time FHLB has had the option to convert to a floating interest rate based on the 3 month LIBOR + 0.11%. The interest rate was 4.47% at December 31, 2013 and 2012.

(f) Interest rate was fixed at 3.97% until October 2009, since which time FHLB has had the option to convert to a floating interest rate based on the 3 month LIBOR + 0.10%. The interest rate was 3.97% at December 31, 2013 and 2012.

(h) Fixed rate borrowing at an interest rate of 4.31%, with monthly principal and interest payments and a balloon payment due at maturity.

Table of Contents

(i) Fixed rate borrowing at an interest rate of 5.24%, with monthly principal and interest payments and a balloon payment due at maturity.

(j) Fixed rate borrowing at an interest rate of 3.35%, with monthly principal and interest payments.

(k) Fixed rate borrowing at an interest rate of 4.00%, with monthly principal and interest payments.

(l) Fixed rate borrowing at an interest rate of 3.23%, with monthly principal and interest payments.

The terms of borrowings (a) through (g) are interest only payments with principal due at maturity.

Each advance is payable at its maturity date, with a prepayment penalty for fixed rate advances.

Other Borrowings

At December 31, 2013 and 2012, the Bank had outstanding borrowings of $12,950 and $23,510 from one unaffiliated institution under an overnight borrowing agreement. The interest rate on this borrowing was 0.35%.

The Bank entered into a borrowing transaction with an unaffiliated institution in March 2007. The proceeds of this borrowing were $10,000 and, as part of this transaction, the Bank pledged certain securities which had a carrying amount of $12,222 at December 31, 2013. The borrowing has a maturity date of March 20, 2017 and a variable interest rate of 3 month LIBOR minus 1.0% through March 20, 2008, at which time the interest rate became fixed as defined. The borrowing is callable by the issuer at the end of each quarter until maturity. The interest rate was 5.25% at December 31, 2013 and 2012.

Subordinated Debentures

In 2007, the Corporation issued two $10,000 floating rate trust preferred securities as part of a pooled offering of such securities. The interest rate on each offering is determined quarterly and floats based on the 3 month LIBOR plus 1.55% and was 1.79% and 1.86% at December 31, 2013 and 2012, respectively. The Corporation issued subordinated debentures to the trusts in exchange for the proceeds of the offerings, which debentures represent the sole assets of the trusts. The subordinated debentures must be redeemed no later than 2037. The Corporation may redeem the debentures, in whole or in part, at face value at any time. The Corporation has the option to defer interest payments from time to time for a period not to exceed five consecutive years.

Although the trusts are variable interest entities, the Corporation is not the primary beneficiary. As a result, because the trusts are not consolidated with the Corporation, the Corporation does not report the securities issued by the trusts as liabilities. Instead, the Corporation reports as liabilities the subordinated debentures issued by the Corporation and held by the trusts, since the liabilities are not eliminated in consolidation.

Table of Contents

Maturity Schedule of All Borrowed Funds

The following is a schedule of maturities of all borrowed funds as of December 31, 2013:

2014	$	13,159
2015		20,218
2016		227
2017		50,237
2018		246
Thereafter		24,483
Total borrowed funds	$	108,570

12. Interest Rate Swaps

On May 3, 2011, the Corporation executed an interest rate swap agreement with a 5 year term and an effective date of September 15, 2013 in order to hedge cash flows associated with $10 million of a subordinated note that was issued by the Corporation during 2007 and elected cash flow hedge accounting for the agreement. The Corporation s objective in using this derivative is to add stability to interest expense and to manage its exposure to interest rate risk. The interest rate swap involves the receipt of variable-rate amounts in exchange for fixed-rate payments from September 15, 2013 to September 15, 2018 without exchange of the underlying notional amount. At December 31, 2013, the variable rate on the subordinated debt was 1.79% (LIBOR plus 155 basis points) and the Corporation was paying 5.57% (4.02% fixed rate plus 155 basis points).

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

As of December 31, 2013 and 2012, no derivatives were designated as fair value hedges or hedges of net investments in foreign operations. Additionally, the Corporation does not use derivatives for trading or speculative purposes and currently does not have any derivatives that are not designated as hedges.

Table of Contents

The following tables provide information about the amounts and locations of activity related to the interest rate swaps designated as cash flow hedges within the Corporation s consolidated balance sheet and statement of income as of December 31, 2013 and 2012 and for the years ended December 31, 2013, 2012, and 2011:

As of December 31		Liability Derivative	
	Balance Sheet Location	Fair value 2013	2012
Interest rate contract	Accrued interest and other liabilities	($1,116)	($1,745)

For the Year Ended December 31, 2013	(a)	(b)	(c)	(d)	(e)
Interest rate contract	$409	Interest expense subordinated debentures	($400)	Other income	$0
For the Year Ended December 31, 2012					
Interest rate contract	($49)	Interest expense subordinated debentures	($390)	Other income	$0
For the Year Ended December 31, 2011					
Interest rate contract	($522)	Interest expense subordinated debentures	($402)	Other income	$0

(a) Amount of Gain or (Loss) Recognized in Other Comprehensive Loss on Derivative (Effective Portion), net of tax

(b) Location of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)

(c) Amount of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)

(d) Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)

(e) Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)

Amounts reported in accumulated other comprehensive loss related to the interest rate swap will be reclassified to interest expense as interest payments are made on the subordinated debentures. Such amounts reclassified from accumulated other comprehensive loss to interest expense in the next twelve months are expected to be $378.

As of December 31, 2013 and 2012, a cash collateral balance in the amount of $1,400 and $1,950, respectively, was maintained with the counterparty to the interest rate swaps. These balances are included in interest bearing deposits with other banks on the consolidated balance sheets.

Table of Contents

13. Income Taxes

The following is a summary of income tax expense for the years ended December 31, 2013, 2012, and 2011:

	2013	2012	2011
Current federal	$ 7,189	$ 6,535	$ 4,951
Current state	128	116	137
Deferred - federal	(977)	(240)	441
Income tax expense	$ 6,340	$ 6,411	$ 5,529

The components of the net deferred tax asset (liability) as of December 31, 2013 and 2012 are as follows:

	2013	2012
Deferred tax assets:		
Allowance for loan losses	$ 5,084	$ 4,632
Unrealized loss on securities available for sale	4,085	0
Fair value adjustments business combination	3,541	0
Deferred compensation	2,179	1,753
Impaired security valuation	590	670
Net operating loss carryover	2,155	0
Capital loss carryover	0	278
Post-retirement benefits	1,308	1,063
Unrealized loss on interest rate swap	391	616
Nonaccrual loan interest	516	305
Accrued expenses	817	297
Other	296	312
	20,962	9,926
Deferred tax liabilities:		
Unrealized gain on securities available for sale	0	8,636
Premises and equipment	1,527	1,535
Intangibles section 197	5,130	3,179
Mortgage servicing rights	317	250
Other	328	339
	7,302	13,939
Net deferred tax asset (liability)	$ 13,660	($ 4,013)

The Corporation determined that it was not required to establish a valuation allowance for deferred tax assets since management believes that the deferred tax assets are likely to be realized through a carry back to taxable income in prior years, future reversals of existing temporary differences, and future taxable income.

87

Table of Contents

The reconciliation of income tax attributable to pre-tax income at the federal statutory tax rates to income tax expense is as follows:

	2013	%	2012	%	2011	%
Tax at statutory rate	$ 8,057	35.0	$ 8,241	35.0	$ 7,222	35.0
Tax exempt income, net	(1,664)	(7.2)	(1,553)	(6.6)	(1,353)	(6.6)
Bank owned life insurance	(543)	(2.4)	(341)	(1.4)	(325)	(1.6)
Merger costs	233	1.0	0	0.0	0	0.0
Other	257	1.1	64	0.2	(15)	(0.0)
Income tax expense	$ 6,340	27.5	$ 6,411	27.2	$ 5,529	26.8

At December 31, 2013 and 2012, the Corporation has no unrecognized tax benefits. The Corporation does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months.

The Corporation recognizes interest and/or penalties related to income tax matters as part of income tax expense. At December 31, 2013 and 2012, there were no amounts accrued for interest and/or penalties.

The Corporation and its subsidiaries are subject to U.S. federal income tax as well as income tax of the Commonwealth of Pennsylvania. The Corporation is no longer subject to examination by the taxing authorities for years prior to 2010. Tax years 2010 through 2012 remain open to federal and state examination.

In connection with its acquisition of FC Banc Corp., the Corporation assumed a federal net operating loss carryforward of $6,367, which expires in 2033. Under Section 382 of the Internal Revenue Code, the utilization of the loss carryforward in future years is limited based on the consideration paid and other factors. Management believes that the net operating loss carryforward will be used in full before its expiration.

14. Employee Benefit Plans

The Corporation sponsors a contributory defined contribution Section 401(k) plan in which substantially all employees participate. The plan permits employees to make pre-tax contributions which are matched by the Corporation at 100% for every 1% contributed up to three percent then 50% for every 1% contributed up to the next four percent in total of the employee s compensation. The Corporation s contributions were $431, $397, and $385 in 2013, 2012, and 2011, respectively. Profit sharing contributions to this plan, based on current year compensation, are 6 percent of total compensation plus 5.7 percent of the compensation in excess of $114. The Corporation recognized profit sharing expense of $855, $783, and $667 in 2013, 2012, and 2011 respectively.

The Corporation has adopted a non-qualified supplemental executive retirement plan (SERP) for certain executives to compensate those executive participants in the Corporation s retirement plan whose benefits are limited by compensation limitations under current tax law. The SERP is considered an unfunded plan for tax and ERISA purposes and all obligations arising under the SERP are payable from the general assets of the Corporation. At December 31, 2013 and 2012, obligations of $4,120 and $3,792, respectively, were included in other liabilities for this plan. Expenses related to this plan were $541 in 2013, $728 in 2012, and $647 in 2011.

Table of Contents

The Corporation has established a Survivor Benefit Plan for the benefit of outside directors. The purpose of the plan is to provide life insurance benefits to beneficiaries of the Corporation s directors who at the time of their death are participants in the plan. The plan is considered an unfunded plan for tax and ERISA purposes and all obligations arising under the plan are payable from the general assets of the Corporation. At December 31, 2013 and 2012, obligations of $932 and $813, respectively, were included in other liabilities for this plan. Expenses related to this plan were $119 in 2013, $127 in 2012, and $106 in 2011.

The Corporation has an unfunded post retirement benefits plan which provides certain health care benefits for retired employees who have reached the age of 60 and retired with 30 years of service. The plan was amended in 2013 to include only employees hired prior to January 1, 2000. Benefits are provided for these retired employees and their qualifying dependents from the age of 60 through the age of 65.

The following table sets forth the change in the benefit obligation of the plan as of and for the years ended December 31, 2013, 2012, and 2011:

	2013	2012	2011
Benefit obligation at beginning of year	$ 2,224	$ 1,674	$ 1,073
Interest cost	84	69	56
Service cost	125	88	49
Actual claims	(167)	(184)	(262)
Plan amendment	(602)	0	0
Actuarial loss	821	577	758
Benefit obligation at end of year	$ 2,485	$ 2,224	$ 1,674

Amounts recognized in accumulated other comprehensive income at December 31, 2013 and 2012 consist of:

	2013	2012
Net actuarial loss	$ (1,667)	$ (1,502)
Transition obligation	0	(7)
	(1,667)	(1,509)
Tax effect	583	528
	$ (1,084)	$ (981)

The accumulated benefit obligation was $2,485 and $2,224 at December 31, 2013 and 2012, respectively.

Table of Contents

The following table sets forth the components of net periodic benefit cost and other amounts recognized in other comprehensive income:

	2013	2012	2011
Service cost	$ 125	$ 88	$ 49
Interest cost	84	69	56
Net amortization of transition obligation and actuarial loss	61	41	11
Net periodic benefit cost	270	198	116
Net loss	821	578	758
Plan amendment	(602)	0	0
Amortization of loss	(54)	(34)	(4)
Amortization of transition obligation	(7)	(7)	(7)
Total recognized in other comprehensive income	158	537	747
Total recognized in net periodic benefit cost and other comprehensive income	$ 428	$ 735	$ 863

The estimated net loss that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year is $149.

The weighted average discount rate used to calculate net periodic benefit cost was 3.88% in 2013, 4.29% in 2012, and 5.50% in 2011. The weighted average rate used to calculate accrued benefit obligations was 4.31% in 2013, 3.88% in 2012, and 4.29% in 2011. The health care cost trend rate used to measure the expected costs of benefits is 5.0% for 2014 and thereafter. A one percent increase in the health care trend rates would result in an increase of $241 in the benefit obligation as of December 31, 2013, and would increase the service and interest costs by $21 in future periods. A similar one percent decrease in health care trend rates would result in a decrease of $217 and $19 in the benefit obligation and services and interest costs, respectively, at December 31, 2013.

15. Deferred Compensation Plans

Deferred compensation plans cover all directors and certain officers. Under the plans, the Corporation pays each participant, or their beneficiary, the value of the participant s account over a maximum period of 10 years, beginning with the individual s termination of service. A liability is accrued for the obligation under these plans.

A summary of changes in the deferred compensation plan liability follows:

	2013	2012	2011
Balance, beginning of year	$ 990	$ 987	$ 1,038
Deferrals, dividends, and changes in fair value recorded as an expense	191	84	80
Deferred compensation payments	(81)	(81)	(131)
Balance, end of year	$ 1,100	$ 990	$ 987

Table of Contents

16. Stock-Based Compensation

Stock Options

A summary of the status of the stock options is presented below:

	Stock Options	Weighted-average Exercise Price
Outstanding at January 1, 2013	75,500	$ 16.79
Exercised	(40,000)	17.45
Outstanding at December 31, 2013	35,500	$ 16.04
Options vested and exercisable at December 31, 2013	35,500	
Fair value of options granted during 2013	N/A	
Number of authorized stock-based awards available for grant	393,441	

Options outstanding and exercisable at December 31, 2013 are as follows:

Exercise Price	Number	Remaining Contractual Life
$16.04	35,500	1.0 years

The aggregate intrinsic value of all options outstanding and exercisable at December 31, 2013 and 2012 was $105 and $13, respectively.

Additional information related to the stock option plan follows:

	2013	2012	2011
Intrinsic value of options exercised	$ 99	$114	$ 151
Cash received from option exercises	698	424	259

As of December 31, 2013, there was no unrecognized compensation cost related to nonvested stock options granted under the stock option plan.

Restricted Stock Awards

A summary of changes in nonvested restricted stock awards follows:

	Shares	Weighted-average Grant Date Fair Value
Nonvested at January 1, 2013	49,574	$15.37
Granted	31,500	17.10

Forfeited	(525)	16.44
Vested	(18,473)	15.33
Nonvested at December 31, 2013	62,076	$16.25

91

Table of Contents

As of December 31, 2013 and 2012, there was $675 and $536, respectively, of total unrecognized compensation cost related to nonvested shares granted under the restricted stock award plan. The fair value of shares vesting during 2013, 2012, and 2011 was $323, $206 and $173, respectively. Compensation expense for restricted stock awards was $390 in 2013, $277 in 2012, and $213 in 201.

17. Related Party Transactions

In the ordinary course of business, the Bank has transactions, including loans, with its officers, directors, and their affiliated companies. The aggregate of such loans totaled $2,238 on December 31, 2013 compared to $1,144 at December 31, 2012. During 2013, $1,432 new loans were made, $125 was added due to a change in the composition of related parties, and repayments totaled $463.

Deposits from principal officers, directors, and their affiliates were $48,249 and $25,293 at December 31, 2013 and 2012, respectively.

18. Capital Requirements and Restrictions on Retained Earnings

Banks and financial holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, for the Bank, prompt corrective action (PCA) regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can result in regulatory enforcement actions. Management believes as of December 31, 2013 the Corporation and Bank meet all capital adequacy requirements to which they are subject.

The PCA regulations provide five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms alone do not represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion; brokered deposits may not be accepted, renewed or rolled over; and capital restoration plans are required. As of December 31, 2013 and 2012, the most recent regulatory notifications categorized the Bank as well capitalized under the PCA regulatory framework. There are no events or conditions since this notification that management believes have changed the Bank s capital category.

Table of Contents

Actual and required capital amounts and ratios are presented below as of December 31, 2013 and 2012:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2013						
Total Capital to Risk Weighted Assets						
Consolidated	$183,984	13.72%	$107,316	8.0%	N/A	
Bank	$166,440	12.57%	$105,912	8.0%	$132,390	10.0%
Tier 1 (Core) Capital to Risk Weighted Assets						
Consolidated	$167,773	12.51%	$53,658	4.0%	N/A	
Bank	$151,585	11.45%	$52,956	4.0%	$79,434	6.0%
Tier 1 (Core) Capital to Average Assets						
Consolidated	$167,773	7.96%	$84,332	4.0%	N/A	
Bank	$151,585	7.39%	$82,078	4.0%	$102,597	5.0%
December 31, 2012						
Total Capital to Risk Weighted Assets						
Consolidated	$152,968	15.28%	$80,073	8.0%	N/A	
Bank	$131,788	13.46%	$78,324	8.0%	$97,905	10.0%
Tier 1 (Core) Capital to Risk Weighted Assets						
Consolidated	$140,426	14.03%	$40,036	4.0%	N/A	
Bank	$119,534	12.21%	$39,162	4.0%	$58,743	6.0%
Tier 1 (Core) Capital to Average Assets						
Consolidated	$140,426	8.06%	$69,726	4.0%	N/A	
Bank	$119,534	6.99%	$68,409	4.0%	$85,512	5.0%

Certain restrictions exist regarding the ability of the Bank to transfer funds to the Corporation in the form of cash dividends, loans or advances. At December 31, 2013, $22,763 of accumulated net earnings of the Bank, included in the consolidated stockholders equity, was available for distribution to the Corporation as dividends without prior regulatory approval, subject to regulatory capital requirements described above.

19. Off Balance Sheet Activities

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off balance sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

The contractual amount of financial instruments with off balance sheet risk was as follows at December 31, 2013 and 2012:

	2013		2012	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Commitments to make loans	$54,556	$155,391	$13,670	$171,862
Unused lines of credit	0	78,937	0	69,621
Standby letters of credit	0	13,520	0	22,598

Commitments to make loans are generally made for periods of 60 days or less. The fixed rate loan commitments at December 31, 2013 have interest rates ranging from 2.15% to 18.00% and maturities ranging from 3 months to 20 years. The fixed rate loan commitments at December 31, 2012 have interest rates ranging from 2.15% to 16.00% and maturities ranging from 3 months to 20 years.

20. Fair Value

Fair Value Measurement

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

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

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

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

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

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

Table of Contents

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

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

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

		Fair Value Measurements at December 31, 2013 Using		
Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Securities Available For Sale:				
U.S. Treasury	$ 0	$ 0	$ 0	$ 0
U.S. Government sponsored entities	181,625	0	181,625	0
States and political subdivisions	177,943	0	177,943	0
Residential and multi-family mortgage	242,607	0	242,607	0
Commercial mortgage	374	0	374	0
Corporate notes and bonds	14,075	0	14,075	0
Pooled trust preferred	661	0	0	661
Pooled SBA	67,721	0	67,721	0
Other securities	985	985	0	0
Total Securities Available For Sale	$ 685,991	$ 985	$ 684,345	$ 661
Trading Securities:				
Corporate equity securities	$ 2,705	$ 2,705	$ 0	$ 0
Certificates of deposit	253	253	0	0
International mutual funds	259	259	0	0
Large cap growth mutual funds	197	197	0	0
Money market mutual funds	124	124	0	0
Large cap value mutual funds	129	129	0	0
Corporate notes and bonds	152	0	152	0
Real estate investment trust mutual funds	39	39	0	0
U.S. Government sponsored entities	52	0	52	0
Small cap mutual funds	83	83	0	0
Mid cap mutual funds	84	84	0	0
Commodities mutual funds	50	50	0	0
Total Trading Securities	$ 4,127	$ 3,923	$ 204	$ 0
Liabilities,				
Interest rate swaps	$ (1,116)	$ 0	$ (1,116)	$ 0

Table of Contents

Description	Total	Fair Value Measurements at December 31, 2012 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Securities Available For Sale:				
U.S. Treasury	$ 4,036	$ 0	$ 4,036	$ 0
U.S. Government sponsored entities	163,781	0	163,781	0
States and political subdivisions	181,279	0	181,279	0
Residential and multi-family mortgage	316,822	0	316,822	0
Commercial mortgage	1,304	0	1,304	0
Corporate notes and bonds	15,024	0	13,044	1,980
Pooled trust preferred	600	0	0	600
Pooled SBA	52,927	52,631	296	0
Other securities	1,538	1,538	0	0
Total Securities Available For Sale	$ 737,311	$ 54,169	$ 680,562	$ 2,580
Trading Securities:				
Corporate equity securities	$ 3,117	$ 3,117	$ 0	$ 0
Certificates of deposit	408	408	0	0
International mutual funds	287	287	0	0
Large cap growth mutual funds	157	157	0	0
Money market mutual funds	110	110	0	0
Large cap value mutual funds	104	104	0	0
Corporate notes and bonds	101	0	101	0
Real estate investment trust mutual funds	65	65	0	0
U.S. Government sponsored entities	58	0	58	0
Small cap mutual funds	26	26	0	0
Mid cap mutual funds	26	26	0	0
Total Trading Securities	$ 4,459	$ 4,300	$ 159	$ 0
Liabilities,				
Interest rate swaps	$ (1,745)	$ 0	$ (1,745)	$ 0

The table below presents a reconciliation and income statement classification of gains and losses for all securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31, 2013:

	Corporate notes and bonds	Pooled trust preferred
Balance, January 1, 2013	$ 1,980	$ 600
Total gains or (losses):		
Included in other comprehensive income (loss)	(29)	61
Included in realized gains on available-for-sale securities	58	0
Sale of available-for-sale securities	(2,009)	0

Balance, December 31, 2013	$	0	$	661

The table below presents a reconciliation and income statement classification of gains and losses for all securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31, 2012:

	Corporate notes and bonds	Pooled trust preferred
Balance, January 1, 2012	$ 2,060	$ 340
Total gains or (losses):		
Included in other comprehensive income (unrealized)	(80)	260
Balance, December 31, 2012	$ 1,980	$ 600

The following table presents quantitative information about Level 3 fair value measurements at December 31, 2013:

	Fair value	Valuation Technique	Unobservable Inputs	Input Utilized
Pooled trust preferred	$ 661	Discounted cash flow	Collateral default rate	2% in 2014; 1.5% in 2015; 1.0% in 2016; 0.5% in 2017 and thereafter
			Yield	15%
			Prepayment speed	2.0% constant prepayment rate in 2014 and thereafter

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

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

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

During the year ended December 31, 2013, $52,631 of available for sale Pooled SBA securities reported as Level 1 securities as of the beginning of the year were transferred to the Level 2 category since the Corporation could not obtain quoted prices for identical assets in active markets.

Table of Contents

During the year ended December 31, 2012, the following available for sale securities reported as Level 1 securities as of the beginning of the year were transferred to the Level 2 category:

	2012
U.S. Government sponsored entities	$ 2,000
States and political subdivisions	4,655
Residential and multi-family mortgage	8,577
Total	$ 15,232

These securities were transferred from the Level 1 category to the Level 2 category since there were no longer quoted prices for identical assets in active markets that the Corporation had the ability to access. There were no transfers of securities from Level 2 to Level 1 during the years ended December 31, 2013 or 2012. The Corporation s policy for determining when a transfer between the Level 1 and Level 2 categories has occurred is to monitor and report such transfers as of each quarterly reporting period.

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

		Fair Value Measurements at December 31, 2013 Using		
Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans:				
Commercial mortgages	$ 3,000	0	0	$ 3,000
Commercial, industrial, and agricultural	3,706	0	0	3,706

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

Impaired loans, which are measured for impairment using the fair value of collateral for collateral dependent loans, had a principal balance of $8,161, with a valuation allowance of $1,455 as of December 31, 2013, resulting in an additional provision for loan losses of $1,415 for the year then ended. Impaired loans had a principal balance of $12,535, with a valuation allowance of $1,738 as of December 31, 2012, resulting in an additional provision for loan losses of $2,558 for the year then ended.

Table of Contents

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

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2013:

	Fair value	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans commercial mortgages	$ 3,000	Sales comparison approach	Adjustment for differences between the comparable sales	17% 61% (22%)
Impaired loans commercial, industrial, and agricultural	$ 3,274	Sales comparison approach	Adjustment for differences between the comparable sales	9%
Impaired loans commercial, industrial, and agricultural	$ 432	Income approach	Adjustment for differences in net operating income	2%

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

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

Table of Contents

Fair Value of Financial Instruments

The following table presents the carrying amount and fair value of financial instruments at December 31, 2013:

	Carrying	Fair Value Measurement Using:			Total
	Amount	Level 1	Level 2	Level 3	Fair Value
ASSETS					
Cash and cash equivalents	$ 29,633	$ 29,633	$ 0	$ 0	$ 29,633
Interest bearing time deposits with other banks	275	0	274	0	274
Securities available for sale	685,991	985	684,345	661	685,991
Trading securities	4,127	3,923	204	0	4,127
Loans held for sale	487	0	507	0	507
Net loans	1,279,129	0	0	1,276,622	1,276,622
FHLB and other equity interests	7,533	n/a	n/a	n/a	n/a
Accrued interest receivable	8,032	368	3,302	4,362	8,032
LIABILITIES					
Deposits	$ (1,835,314)	$ (1,569,552)	$ (265,237)	$ 0	$ (1,834,789)
FHLB and other borrowings	(87,950)	0	(87,833)	0	(87,833)
Subordinated debentures	(20,620)	0	(11,178)	0	(11,178)
Interest rate swaps	(1,116)	0	(1,116)	0	(1,116)
Accrued interest payable	(868)	(200)	(653)	(15)	(868)

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

	Carrying	Fair Value Measurement Using:			Total
	Amount	Level 1	Level 2	Level 3	Fair Value
ASSETS					
Cash and cash equivalents	$ 31,881	$ 31,881	$ 0	$ 0	$ 31,881
Interest bearing time deposits with other banks	225	0	281	0	281
Securities available for sale	737,311	54,169	680,562	2,580	737,311
Trading securities	4,459	4,300	159	0	4,459
Loans held for sale	2,398	0	2,460	0	2,460
Net loans	913,764	0	0	946,238	946,238
FHLB and other equity interests	6,684	n/a	n/a	n/a	n/a
Accrued interest receivable	6,863	278	3,498	3,087	6,863
LIABILITIES					
Deposits	$ (1,485,003)	$ (1,272,060)	$ (215,485)	$ 0	$ (1,487,545)
FHLB and other borrowings	(97,806)	0	(105,850)	0	(105,850)
Subordinated debentures	(20,620)	0	(10,682)	0	(10,682)
Interest rate swaps	(1,745)	0	(1,745)	0	(1,745)
Accrued interest payable	(1,022)	(301)	(707)	(14)	(1,022)

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

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

Interest bearing time deposits with other banks: The fair value of interest bearing time deposits with other banks is estimated using a discounted cash flow calculation that applies interest rates

currently being offered to a schedule of aggregated expected monthly maturities, resulting in a Level 2 classification.

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

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

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

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

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

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

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

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

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

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

Table of Contents

21. Parent Company Only Financial Information (Dollars in thousands)

CONDENSED BALANCE SHEETS	December 31, 2013	December 31, 2012
Assets		
Cash	$ 1,778	$ 2,029
Trading securities	276	229
Investment in bank subsidiary	161,983	138,195
Investment in non-bank subsidiaries	22,738	27,796
Deferred tax asset	636	883
Other assets	2,240	2,249
Total assets	$ 189,651	$ 171,381
Liabilities		
Borrowings from subsidiary	$ 1,350	$ 1,950
Subordinated debentures	20,620	20,620
Other liabilities	2,770	3,447
Total liabilities	24,740	26,017
Total shareholders equity	164,911	145,364
Total liabilities and shareholders equity	$ 189,651	$ 171,381

CONDENSED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME	Year Ended December 31,		
Income:	2013	2012	2011
Dividends from:			
Bank subsidiary	$ 1,875	$ 7,990	$ 7,600
Non-bank subsidiaries	6,674	0	0
Other	208	208	146
Total income	8,757	8,198	7,746
Expenses	(1,461)	(1,457)	(1,410)
Income before income taxes and equity in undistributed net income of subsidiaries:	7,296	6,741	6,336
Income tax benefit	438	438	443
Equity in undistributed net income of bank subsidiary	14,080	8,682	7,162
Equity in undistributed net income (loss) of non-bank subsidiaries	(5,135)	1,275	1,163
Net income	16,679	17,136	15,104
Other Comprehensive Income (Loss):			
Net change in unrealized gains/losses on available for sale securities, net of reclassification and tax	(23,675)	3,561	14,441
Change in actuarial gain, net of amortization and tax, for post-employment health care plan, net of tax	(103)	(349)	(485)
Change in fair value of interest rate swap agreements designated as a cash flow hedge, net of tax	409	(49)	(522)
Total other comprehensive income (loss)	(23,369)	3,163	13,434

Comprehensive income (loss)	$ (6,690)	$ 20,299	$ 28,538

Table of Contents

CONDENSED STATEMENTS OF CASH FLOWS	Year Ended December 31,		
	2013	2012	2011
Net income			
Adjustments to reconcile net income to net cash provided by	$ 16,679	$ 17,136	$ 15,104
operating activities:			
Equity in undistributed net income of bank subsidiary	(14,080)	(8,682)	(7,162)
Equity in undistributed (net income) loss of non-bank subsidiaries	5,135	(1,275)	(1,163)
Net unrealized (gains) losses on trading securities	(47)	(54)	2
Decrease in other assets	112	47	39
Increase in other liabilities	384	384	334
Net cash provided by operating activities	8,183	7,556	7,154
Cash flows from investing activities:			
Purchase of securities	0	0	(100)
Net cash used in investing activities	0	0	(100)
Cash flows from financing activities:			
Dividends paid	(8,573)	(8,214)	(8,125)
Proceeds from sale of treasury stock and option exercises	739	951	1,447
Net advance to (repayment from) subsidiary	(600)	(200)	400
Net cash used in financing activities	(8,434)	(7,463)	(6,278)
Net increase (decrease) in cash	(251)	93	776
Cash beginning of year	2,029	1,936	1,160
Cash end of year	$ 1,778	$ 2,029	$ 1,936

Table of Contents

22. Other Comprehensive Income

Other comprehensive income components and related tax effects were as follows for the years ended December 31, 2013, 2012, and 2011:

	2013	2012	2011
Unrealized holding gains (losses) on available for sale securities	$ (36,130)	$ 6,597	$ 22,457
Less reclassification adjustment for gains recognized in earnings	(355)	(1,379)	(614)
Net unrealized gains	(36,485)	5,218	21,843
Tax effect	12,770	(1,826)	(7,642)
Net-of-tax amount	(23,715)	3,392	14,201
Unrealized holding gains (losses) on available for sale securities for which a portion of an other-than-temporary impairment has been recognized in earnings	61	260	(28)
Less reclassification adjustment for impairment loss recognized in earnings	0	0	398
Net unrealized gains	61	260	370
Tax effect	(21)	(91)	(130)
Net-of-tax amount	40	169	240
Actuarial loss on postemployment health care plan	(219)	(578)	(757)
Net amortization of transition obligation and actuarial gain	61	41	11
Net unrealized loss on postemployment health care plan	(158)	(537)	(746)
Tax effect	55	188	261
Net-of-tax amount	(103)	(349)	(485)
Unrealized loss on interest rate swap	229	(465)	(1,205)
Less reclassification adjustment for losses recognized in earnings	400	390	402
Net unrealized gain (loss)	629	(75)	(803)
Tax effect	(220)	26	281
Net-of-tax amount	409	(49)	(522)
Other comprehensive income	$ (23,369)	$ 3,163	$ 13,434

Table of Contents

The following is a summary of the change in the accumulated other comprehensive income (loss) balance, net of tax, for the years ended December 31, 2013, 2012, and 2011:

	Balance 1/1/11	Increase (Decrease)	Balance 12/31/11	Increase (Decrease)	Balance 12/31/12	Increase (Decrease)	Balance 12/31/13
Unrealized gains (losses) on securities available for sale	$ (1,963)	$ 14,441	$ 12,478	$ 3,561	$ 16,039	$ (23,675)	$ (7,636)
Unrealized gain (loss) on postretirement benefits plan	(147)	(485)	(632)	(349)	(981)	(103)	(1,084)
Unrealized loss on interest rate swap	(563)	(522)	(1,085)	(49)	(1,134)	409	(725)
Total	$ (2,673)	$ 13,434	$ 10,761	$ 3,163	$ 13,924	$ (23,369)	$ (9,445)

23. Quarterly Financial Data (Unaudited)

The unaudited quarterly results of operations for the years ended December 31, 2013 and 2012 are as follows (in thousands, except per share data):

	Quarters Ended in 2013				Quarters Ended in 2012			
	Mar. 31	June 30	Sept. 30	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31
Total interest and dividend income	$ 16,704	$ 16,758	$ 17,465	$ 20,489	$ 16,824	$ 17,207	$ 17,133	$ 16,965
Net interest income	13,451	13,826	14,648	17,279	12,677	13,274	13,670	13,588
Provision for loan losses	930	3,115	846	1,247	1,104	1,746	1,188	2,343
Non-interest income	3,071	3,771	3,248	3,676	3,518	3,264	3,079	2,803
Non-interest expense	9,682	10,793	10,343	12,995	9,014	8,833	9,208	8,890
Net income	4,297	2,951	4,703	4,728	4,347	4,336	4,563	3,890
Net income per share, basic	0.34	0.24	0.38	0.33	0.35	0.35	0.37	0.31
Net income per share, diluted	0.34	0.24	0.38	0.33	0.35	0.35	0.37	0.31

During the quarter ended December 31, 2013, the Corporation completed its acquisition of FC Banc Corp. FC Banc Corp. results of operations were included in the Corporation s results beginning October 12, 2013. A provision for loan losses in the amount of $2,343 was recorded during the quarter ended December 31, 2012 as a result of specific reserves required for impaired loans in the commercial, industrial, and agricultural loan portfolio in the fourth quarter of 2012.

Table of Contents

Report of Independent Registered Public Accounting Firm

Crowe Horwath LLP

Independent Member Crowe Horwath International

Board of Directors and Shareholders

CNB Financial Corporation

Clearfield, Pennsylvania

We have audited the accompanying consolidated balance sheets of CNB Financial Corporation as of December 31, 2013 and 2012, and the related consolidated statements of income and comprehensive income, cash flows, and changes in shareholders equity for each of the years in the three-year period ended December 31, 2013. We also have audited CNB Financial Corporation s internal control over financial reporting as of December 31, 2013 based on criteria established in the 1992 Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). CNB Financial Corporation s management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control Over Financial Reporting located in Item 9A of Form 10-K. Our responsibility is to express an opinion on these financial statements and an opinion on the company s internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Table of Contents

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As permitted, the Corporation excluded the operations of the financial institution acquired during 2013, which is described in Note 2 of the consolidated financial statements, from the scope of management s report on internal control over financial reporting. As such, it has also been excluded from the scope of our audit of internal control over financial reporting.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of CNB Financial Corporation as of December 31, 2013 and 2012, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, CNB Financial Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in the 1992 Internal Control Integrated Framework issued by the COSO.

/s/ Crowe Horwath LLP

Crowe Horwath LLP

Cleveland, Ohio

March 7, 2014

Table of Contents

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

ITEM 9A. CONTROLS AND PROCEDURES

The Corporation s management, under the supervision of and with the participation of the Corporation s Principal Executive Officer and Principal Financial Officer, has carried out an evaluation of the design and effectiveness of the Corporation s disclosure controls and procedures as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Securities Exchange Act of 1934 as of the end of the period covered by this report. Based upon that evaluation, management, including the Principal Executive Officer and Principal Financial Officer, have concluded that, as of the end of such period, the Corporation s disclosure controls and procedures are effective to provide reasonable assurance that all material information required to be disclosed in reports the Corporation files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission s rules and forms.

There was no significant change in the Corporation s internal control over financial reporting that occurred during the quarter ended December 31, 2013 that has materially affected, or that is reasonably likely to materially affect, our internal control over financial reporting.

Management s Report on Internal Control Over Financial Reporting

The management of the Corporation is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. The Corporation s internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the U.S.

The Corporation s internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Corporation; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Corporation are being made only in accordance with authorizations of management and directors of the Corporation; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Corporation s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Table of Contents

Management assessed the effectiveness of the Corporation s internal control over financial reporting as of December 31, 2013. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in the 1992 Internal Control-Integrated Framework. Based on our assessment and those criteria, management concluded that the Corporation maintained effective internal control over financial reporting as of December 31, 2013. The effectiveness of our internal control over financial reporting as of December 31, 2013 has been audited by Crowe Horwath LLP, an independent registered public accounting firm that audited the Corporation s financial statements, as stated in their report which is located in Item 8 of this Form 10-K.

Management s assessment of the effectiveness of the Corporation s internal control over financial reporting excluded FC Banc Corp., of which the Corporation had the right to control 100% of FC Banc Corp. shares during year-end 2013. This entity represented, in the aggregate, 17% and 5% of consolidated total assets and consolidated net interest income, respectively, of the Corporation as of and for the year ended December 31, 2013. This acquisition is more fully discussed in Note 2 to our consolidated financial statements for year-end 2013. Under guidelines established by the SEC, companies are allowed to exclude acquisitions from their first assessment of internal control over financial reporting following the date of the acquisition.

Joseph B. Bower, Jr.	Brian W. Wingard
President and Chief Executive Officer	Treasurer and Principal Financial Officer
Date: March 7, 2014	Date: March 7, 2014

Table of Contents

ITEM 9B. OTHER INFORMATION

None

PART III.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

See Part I Item 1 Executive Officers for information about our executive officers, which is incorporated by reference in this Item 10. Other information required by this Item 10 is incorporated herein by reference to our definitive proxy statement for our 2014 annual meeting of stockholders (the 2014 proxy statement), which we will file with the SEC on or before 120 days after our 2013 fiscal year-end, and which will appear in the 2014 proxy statement under the captions Proposal 1. Election of Class 1 Directors, Corporate Governance Meetings and Committees of the Board of Directors Audit Committee and Section 16(a) Beneficial Ownership Reporting Compliance.

The Corporation s board of directors has approved a Code of Ethics for Officers and Directors. The Code of Ethics can be found at the Bank s website, www.bankcnb.com.

ITEM 11. EXECUTIVE COMPENSATION

Information required by this Item 11 is incorporated herein by reference to the 2014 proxy statement, including the information in the 2014 proxy statement appearing under the captions Executive Compensation and Compensation of Directors.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information required by this Item 12 is incorporated herein by reference to the 2014 proxy statement, including the information in the 2014 proxy statement appearing under the captions Stock Ownership and Equity Compensation Plan Information.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Information required by this Item 13 is incorporated herein by reference to the 2014 proxy statement, including the information in the 2014 proxy statement appearing under the captions Corporate Governance and Certain Transactions.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information required by this Item 14 is incorporated herein by reference to the 2014 proxy statement, including the information in the 2014 proxy statement appearing under the captions Corporate Governance Meetings and Committees of the Board of Directors Audit Committee and Concerning the Independent Registered Public Accountants.

Table of Contents

PART IV.

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)(1) The following consolidated financial statements are set forth in Part II, Item 8:

Consolidated Balance Sheets as of December 31, 2013 and 2012

Consolidated Statements of Income and Comprehensive Income for the years ended December 31, 2013, 2012, and 2011

Consolidated Statements of Cash Flows for the years ended December 31, 2013, 2012 and 2011

Consolidated Statements of Changes in Shareholders Equity for the years ended December 31, 2013, 2012, and 2011

Notes to Consolidated Financial Statements

(a)(2)Financial statement schedules are not applicable or are included in the consolidated financial statements or related notes.

(a)(3)The following exhibits (asterisk denotes management contract or compensatory plan) are filed as a part of this report:

Exhibit No.	Description
2.1	Agreement and Plan of Merger, dated as of March 26, 2013, by and between the Corporation and FC Banc Corp., filed with the SEC as Exhibit 2.1 to the Corporation s Current Report on Form 8-K filed on March 26, 2013, and incorporated herein by reference.
3.1	Amended and Restated Articles of Incorporation of the Corporation, filed as Appendix B to the 2006 Proxy Statement, filed with the SEC on March 24, 2006, and incorporated herein by reference.
3.2	By-Laws of the Corporation, as amended and restated, filed as Appendix C to the 2006 Proxy Statement, filed with the SEC on March 24, 2006, and incorporated herein by reference.
10.1	Employment contract with Joseph B. Bower, Jr., President and Chief Executive Officer, filed as Exhibit 10.1 to Form 8-K, filed with the SEC on March 9, 2012, and incorporated herein by reference.*
10.2	1999 Stock Incentive Plan, filed as Exhibit A to the 1999 Proxy Statement, filed with the SEC on March 29, 1999, and incorporated herein by reference.*
10.3	Employment contract with Richard L. Sloppy, Executive Vice President/Chief Lending Officer, filed as Exhibit 10.3 to Form 8-K, filed with the SEC on March 9, 2012, and incorporated herein by reference.*
10.4	2009 Stock Incentive Plan, filed as Exhibit 10(iii)-4 to Registration Statement No. 333-159941, filed with the SEC on November 12, 2009, and incorporated herein by reference.*

Table of Contents

Exhibit No.	Description
10.5	Employment contract with Mark D. Breakey, Executive Vice President/Chief Credit Officer, filed as Exhibit 10.4 to Form 8-K, filed with the SEC on March 9, 2012, and incorporated herein by reference.*
10.6	Employment contract with Richard L. Greslick, Jr., Executive Vice President/Chief Operating Officer, filed as Exhibit 10.2 to Form 8-K, filed with the SEC on March 9, 2012, and incorporated herein by reference.*
10.7	Executive employment contract with Joseph E. Dell, Jr., dated September 23, 2013, filed herewith.*
21	Subsidiaries of the Registrant, filed as Exhibit 21 herewith.
23.1	Consent of Independent Registered Public Accounting Firm
31.1	Rule 13a 14(a)/15d 14(a) Certification of the Principal Executive Officer
31.2	Rule 13a 14(a)/15d 14(a) Certification of the Principal Financial Officer
32.1	Section 1350 Certification
32.2	Section 1350 Certification
99.1	Additional information mailed to shareholders with proxy statement and Form 10-K
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definitions Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CNB FINANCIAL CORPORATION
(Registrant)

Date:	March 7, 2014	By:	/s/ Joseph B. Bower, Jr. JOSEPH B. BOWER, JR. President & Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on March 7, 2014.

/s/ Joseph B. Bower, Jr. JOSEPH B. BOWER, JR. President and Director (Principal Executive Officer)	/s/ Dennis L. Merrey DENNIS L. MERREY, Chairman
/s/ Richard L. Greslick, Jr. RICHARD L. GRESLICK, JR. Secretary and Director	/s/Jeffrey S. Powell JEFFREY S. POWELL, Director
/s/ Brian W. Wingard BRIAN W. WINGARD Treasurer (Principal Financial and Accounting Officer)	/s/ James B. Ryan JAMES B. RYAN, Director
/s/ William F. Falger WILLIAM F. FALGER, Director	/s/ Nicholas C. Scott, Jr. RICHARD B. SEAGER, Director
/s/ R. Duane Hord R. DUANE HORD, Director	/s/ Richard B. Seager RICHARD B. SEAGER, Director
/s/ Robert W. Montler ROBERT W. MONTLER, Director	/s/ Peter F. Smith PETER F. SMITH, Director
/s/ Deborah Dick Pontzer DEBORAH DICK PONTZER, Director	
/s/ Joel E. Peterson JOEL E. PETERSON, Director	

EXHIBIT INDEX

Exhibit No.	Description
2.1	Agreement and Plan of Merger, dated as of March 26, 2013, by and between the Corporation and FC Banc Corp., filed with the SEC as Exhibit 2.1 to the Corporation s Current Report on Form 8-K filed on March 26, 2013, and incorporated herein by reference.
3.1	Amended and Restated Articles of Incorporation of the Corporation, filed as Appendix B to the 2006 Proxy Statement, filed with the SEC on March 24, 2006, and incorporated herein by reference.
3.2	By-Laws of the Corporation, as amended and restated, filed as Appendix C to the 2006 Proxy Statement, filed with the SEC on March 24, 2006, and incorporated herein by reference.
10.1	Employment contract with Joseph B. Bower, Jr., President and Chief Executive Officer, filed as Exhibit 10.1 to Form 8-K, filed with the SEC on March 9, 2012, and incorporated herein by reference.*
10.2	1999 Stock Incentive Plan, filed as Exhibit A to the 1999 Proxy Statement, filed with the SEC on March 29, 1999, and incorporated herein by reference.*
10.3	Employment contract with Richard L. Sloppy, Executive Vice President/Chief Lending Officer, filed as Exhibit 10.3 to Form 8-K, filed with the SEC on March 9, 2012, and incorporated herein by reference.*
10.4	2009 Stock Incentive Plan, filed as Exhibit 10(iii)-4 to Registration Statement No. 333-159941, filed with the SEC on November 12, 2009, and incorporated herein by reference.*
10.5	Employment contract with Mark D. Breakey, Executive Vice President/Chief Credit Officer, filed as Exhibit 10.4 to Form 8-K, filed with the SEC on March 9, 2012, and incorporated herein by reference.*
10.6	Employment contract with Richard L. Greslick, Jr., Executive Vice President/Chief Operating Officer, filed as Exhibit 10.2 to Form 8-K, filed with the SEC on March 9, 2012, and incorporated herein by reference.*
10.7	Executive employment contract with Joseph E. Dell, Jr., dated September 23, 2013, filed herewith.
21	Subsidiaries of the Registrant, filed as Exhibit 21 herewith.
23.1	Consent of Independent Registered Public Accounting Firm
31.1	Rule 13a 14(a)/15d 14(a) Certification of the Principal Executive Officer
31.2	Rule 13a 14(a)/15d 14(a) Certification of the Principal Financial Officer
32.1	Section 1350 Certification
32.2	Section 1350 Certification
99.1	Additional information mailed to shareholders with proxy statement and Form 10-K
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definitions Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* Denotes management contract or compensatory plan.