NBT BANCORP INC
Form 10-Q
May 12, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10 Q

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

For the quarterly period ended March 31, 2014.

OR

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

For the transition period from ________ to ________.

COMMISSION FILE NUMBER 0-14703

NBT BANCORP INC.
(Exact Name of Registrant as Specified in its Charter)

DELAWARE	16-1268674
(State of Incorporation)	(I.R.S. Employer Identification No.)

52 SOUTH BROAD STREET, NORWICH, NEW YORK 13815
(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Code: (607) 337-2265

None
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

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

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

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

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

As of April 30, 2014, there were 43,689,389 shares outstanding of the Registrant's common stock, $0.01 par value per share.

NBT BANCORP INC.
FORM 10-Q--Quarter Ended March 31, 2014

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Item 1 – FINANCIAL STATEMENTS

NBT Bancorp Inc. and Subsidiaries
Consolidated Balance Sheets (unaudited)

(In thousands, except share and per share data)	March 31, 2014	December 31, 2013
Assets		
Cash and due from banks	$182,071	$157,625
Short-term interest bearing accounts	3,493	1,301
Securities available for sale, at fair value	1,377,585	1,364,881
Securities held to maturity (fair value $114,920 and $113,276, respectively)	117,896	117,283
Trading securities	6,954	5,779
Federal Reserve and Federal Home Loan Bank stock	41,458	46,864
Loans	5,482,025	5,406,795
Less allowance for loan losses	69,434	69,434
Net loans	5,412,591	5,337,361
Premises and equipment, net	87,647	88,327
Goodwill	263,634	264,997
Intangible assets, net	24,248	25,557
Bank owned life insurance	115,775	114,966
Other assets	119,777	127,234
Total assets	$7,753,129	$7,652,175
Liabilities		
Demand (noninterest bearing)	$1,616,612	$1,645,641
Savings, NOW, and money market	3,482,925	3,223,441
Time	969,361	1,021,142
Total deposits	6,068,898	5,890,224
Short-term borrowings	356,878	456,042
Long-term debt	308,679	308,823
Junior subordinated debt	101,196	101,196
Other liabilities	85,276	79,321
Total liabilities	6,920,927	6,835,606
Stockholders' equity		
Preferred stock, $0.01 par value. Authorized 2,500,000 shares at March 31, 2014 and December 31, 2013	-	-
Common stock, $0.01 par value. Authorized 100,000,000 shares at March 31, 2014 and December 31, 2013; issued 49,651,494 at March 31, 2014 and December 31, 2013	497	497
Additional paid-in-capital	574,071	574,152
Retained earnings	394,589	385,787
Accumulated other comprehensive loss	(11,550)	(16,765)
Common stock in treasury, at cost, 6,050,806 and 6,138,444 shares at March 31, 2014 and December 31, 2013, respectively	(125,405)	(127,102)
Total stockholders' equity	832,202	816,569
Total liabilities and stockholders' equity	$7,753,129	$7,652,175

See accompanying notes to unaudited interim consolidated financial statements.

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NBT Bancorp Inc. and Subsidiaries Consolidated Statements of Income (unaudited)	Three months ended March 31, 2014	 2013
(In thousands, except per share data)		
Interest, fee, and dividend income		
Interest and fees on loans	$60,015	$53,695
Securities available for sale	6,757	5,746
Securities held to maturity	768	525
Other	537	403
Total interest, fee, and dividend income	68,077	60,369
Interest expense		
Deposits	3,284	4,150
Short-term borrowings	231	42
Long-term debt	2,507	3,609
Junior subordinated debt	538	428
Total interest expense	6,560	8,229
Net interest income	61,517	52,140
Provision for loan losses	3,596	5,658
Net interest income after provision for loan losses	57,921	46,482
Noninterest income		
Insurance and other financial services revenue	6,737	6,893
Service charges on deposit accounts	4,369	4,323
ATM and debit card fees	4,072	3,242
Retirement plan administration fees	2,918	2,682
Trust	4,446	2,913
Bank owned life insurance	1,382	849
Net securities gains	7	1,145
Other	2,346	3,182
Total noninterest income	26,277	25,229
Noninterest expense		
Salaries and employee benefits	29,534	27,047
Occupancy	6,226	4,977
Data processing and communications	4,001	3,455
Professional fees and outside services	3,415	2,901
Equipment	3,116	2,582
Office supplies and postage	1,685	1,590
FDIC expenses	1,278	1,130
Advertising	739	723
Amortization of intangible assets	1,310	851
Loan collection and other real estate owned	1,040	718
Merger expenses	-	10,681
Other	5,173	4,050
Total noninterest expense	57,517	60,705
Income before income tax expense	26,681	11,006
Income tax expense	8,672	3,357
Net income	$18,009	$7,649
Earnings per share		
Basic	$0.41	$0.21
Diluted	$0.41	$0.21

See accompanying notes to unaudited interim consolidated financial statements.

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NBT Bancorp Inc. and Subsidiaries Consolidated Statements of Comprehensive Income (unaudited) (In thousands)	Three months ended March 31, 2014	 2013
Net income	$18,009	$7,649
Other comprehensive income (loss), net of tax		
Unrealized net holding gains (losses) arising during the period (pre-tax amounts of $8,623 and ($1,752))	5,208	(1,058)
Reclassification adjustment for net gains related to securities available for sale included in net income (pre-tax amounts of $7 and $1,145)	(4)	(691)
Pension and other benefits:		
Amortization of prior service cost and actuarial gains (pre-tax amounts of $19 and $826)	11	503
Total other comprehensive income (loss)	5,215	(1,246)
Comprehensive income	$23,224	$6,403

See accompanying notes to unaudited interim consolidated financial statements

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NBT Bancorp Inc. and Subsidiaries
Consolidated Statements of Stockholders' Equity (unaudited)

(in thousands, except share and per share data)	Common Stock	Additional Paid-in-Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Common Stock in Treasury	Total
Balance at December 31, 2012	$ 393	$ 346,692	$ 357,558	$ (5,880)	$ (116,490)	$ 582,273
Net income	-	-	7,649	-	-	7,649
Cash dividends - $0.20 per share	-	-	(6,758)	-	-	(6,758)
Issuance of 10,346,363 shares, net of 408,957treasury shares, for Alliance acquisition	104	225,447	-	-	(5,779)	219,772
Net issuance of 28,339 shares to employee benefit plans and other stock plans, including tax benefit	-	(965)	-	-	606	(359)
Stock-based compensation	-	1,964	-	-	-	1,964
Other comprehensive loss	-	-	-	(1,246)	-	(1,246)
Balance at March 31, 2013	$ 497	$ 573,138	$ 358,449	$ (7,126)	$ (121,663)	$ 803,295
Balance at December 31, 2013	$ 497	$ 574,152	$ 385,787	$ (16,765)	$ (127,102)	$ 816,569
Net income	-	-	18,009	-	-	18,009
Cash dividends - $0.21 per share	-	-	(9,207)	-	-	(9,207)
Net issuance of 87,638 shares to employee benefit plans and other stock plans, including tax benefit	-	(1,335)	-	-	1,697	362
Stock-based compensation	-	1,254	-	-	-	1,254
Other comprehensive income	-	-	-	5,215	-	5,215
Balance at March 31, 2014	$ 497	$ 574,071	$ 394,589	$ (11,550)	$ (125,405)	$ 832,202

See accompanying notes to unaudited interim consolidated financial statements.

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NBT Bancorp Inc. and Subsidiaries Consolidated Statements of Cash Flows (unaudited) (In thousands, except per share data)	Three Months Ended March 31, 2014	 2013
Operating activities		
Net income	$18,009	$7,649
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	3,596	5,658
Depreciation and amortization of premises and equipment	2,046	1,791
Net accretion on securities	921	1,091
Amortization of intangible assets	1,310	851
Stock based compensation	1,254	1,964
Increase in surrender value of bank owned life insurance	(968)	(849)
Purchases of trading securities	(1,043)	(744)
Unrealized gains in trading securities	(132)	(100)
Deferred income tax benefit	(18)	(309)
Proceeds from sales of loans held for sale	439	15,417
Originations and purchases of loans held for sale	(1,418)	(17,307)
Net gains on sales of loans held for sale	(3)	(480)
Net security gains	(7)	(1,145)
Net gain on sales of other real estate owned	(102)	(151)
Proceeds from settlement of bank owned life insurance	573	-
Gains on bank owned life insurance settlement	(414)	-
Net decrease in other assets	7,136	915
Net increase (decrease) in other liabilities	1,156	(9,336)
Net cash provided by operating activities	32,335	4,915
Investing activities		
Net cash provided by acquisitions	-	81,049
Securities available for sale:		
Proceeds from maturities, calls, and principal paydowns	67,341	109,986
Proceeds from sales	-	2,607
Purchases	(70,339)	(119,749)
Securities held to maturity:		
Proceeds from maturities, calls, and principal paydowns	5,107	6,940
Purchases	(5,217)	(3,131)
Proceeds from FHLB stock redemption	15,306	1,989
Net increase in loans	(78,304)	(17,791)
Net increase in Federal Reserve and FHLB stock	(9,900)	-
Purchases of premises and equipment	(1,114)	(1,006)
Proceeds from sales of other real estate owned	902	1,023
Net cash (used in) provided by investing activities	(76,218)	61,917
Financing activities		
Net increase in deposits	178,674	118,194
Net (decrease) increase in short-term borrowings	(99,164)	1,326
Repayments of long-term debt	(144)	(43,757)
Proceeds from the issuance of shares to employee benefit plans and other stock plans	362	(359)
Cash dividends and payment for fractional shares	(9,207)	(6,758)
Net cash provided by financing activities	70,521	68,646
Net increase in cash and cash equivalents	26,638	135,478
Cash and cash equivalents at beginning of period	158,926	163,668

Cash and cash equivalents at end of period	$185,564	$299,146

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Supplemental disclosure of cash flow information	Three Months Ended March 31,	
Cash paid during the period for:	2014	2013
Interest	$6,829	$8,000
Income taxes paid	2,745	344
Noncash investing activities:		
Loans transferred to other real estate owned	$460	$959
Acquisitions:		
Fair value of assets acquired	$-	$1,503,448
Fair value of liabilities assumed	-	1,283,676

See accompanying notes to unaudited interim consolidated financial statements.

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NBT BANCORP INC. and Subsidiaries
NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2014

Note 1. Description of Business

NBT Bancorp Inc. (the "Registrant" or the "Company") is a registered financial holding company incorporated in the state of Delaware in 1986, with its principal headquarters located in Norwich, New York. The principal assets of the Registrant consist of all of the outstanding shares of common stock of its subsidiaries, including: NBT Bank, National Association (the "Bank"), NBT Financial Services, Inc. ("NBT Financial"), NBT Holdings, Inc. ("NBT Holdings"), Hathaway Agency, Inc., and CNBF Capital Trust I, NBT Statutory Trust I and NBT Statutory Trust II (collectively, the "Trusts"). The Company's principal sources of revenue are the management fees and dividends it receives from the Bank, NBT Financial and NBT Holdings.
The Company's business, primarily conducted through the Bank but also through its other subsidiaries, consists of providing commercial banking and financial services to customers in its market area, which includes central and upstate New York, northeastern Pennsylvania, southern New Hampshire, western Massachusetts and the greater Burlington, Vermont area. The Company has been, and intends to continue to be, a community-oriented financial institution offering a variety of financial services. The Company's business philosophy is to operate as a community bank with local decision-making, principally in non-metropolitan markets, providing a broad array of banking and financial services to retail, commercial, and municipal customers.

Note 2. Basis of Presentation

The accompanying unaudited interim consolidated financial statements include the accounts of the Registrant and its wholly owned subsidiaries, the Bank, NBT Financial and NBT Holdings. Collectively, the Registrant and its subsidiaries are referred to herein as "the Company." The interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods in accordance with generally accepted accounting principles ("GAAP"). These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our 2013 Annual Report on Form 10-K. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year or any other interim period. All intercompany transactions have been eliminated in consolidation. Amounts in the prior period financial statements are reclassified whenever necessary to conform to current period presentation. The Company has evaluated subsequent events for potential recognition and/or disclosure and there were none identified.

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Note 3. Securities

The amortized cost, estimated fair value, and unrealized gains and losses of securities available for sale are as follows:

(In thousands)	Amortized cost	Unrealized gains	Unrealized losses	Estimated fair value
March 31, 2014				
U.S. Treasury	$33,204	$ 269	$ -	$33,473
Federal Agency	305,245	430	5,517	300,158
State & municipal	111,583	1,967	855	112,695
Mortgage-backed:				
Government-sponsored enterprises	351,748	6,164	1,404	356,508
U.S. government agency securities	20,781	940	71	21,650
Collateralized mortgage obligations:				
Government-sponsored enterprises	501,563	2,080	13,411	490,232
U.S. government agency securities	46,876	656	117	47,415
Other securities	12,839	2,851	236	15,454
Total securities available for sale	$1,383,839	$ 15,357	$ 21,611	$1,377,585
December 31, 2013				
U.S. Treasury	$43,279	$ 337	$ -	$43,616
Federal Agency	285,880	343	7,308	278,915
State & municipal	113,435	1,842	1,612	113,665
Mortgage-backed:				
Government-sponsored enterprises	337,666	5,788	2,131	341,323
U.S. government agency securities	21,924	1,002	85	22,841
Collateralized mortgage obligations:				
Government-sponsored enterprises	521,257	1,777	18,141	504,893
U.S. government agency securities	43,943	794	102	44,635
Other securities	12,367	2,854	228	14,993
Total securities available for sale	$1,379,751	$ 14,737	$ 29,607	$1,364,881

Other securities primarily represent marketable equity securities.

There were no sales of securities available for sale during the three months ended March 31, 2014. Proceeds from the sales of securities available for sale were $2.6 million during the three months ended March 31, 2013, and gains on the sales were $1.1 million. There were no losses on the sales during 2013.

Securities with amortized costs totaling $1.5 billion at March 31, 2014 and $1.4 billion at December 31, 2013 were pledged to secure public deposits and for other purposes required or permitted by law. Additionally, at March 31, 2014 and December 31, 2013, securities with an amortized cost of $224.9 million and $218.4 million, respectively, were pledged as collateral for securities sold under repurchase agreements.

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The amortized cost, estimated fair value, and unrealized gains and losses of securities held to maturity are as follows:

(In thousands)	Amortized cost	Unrealized gains	Unrealized losses	Estimated fair value
March 31, 2014				
Mortgage-backed	$ 881	$ 120	$ -	$ 1,001
Collateralized mortgage obligations	60,973	-	3,444	57,529
State & municipal	56,042	361	13	56,390
Total securities held to maturity	$ 117,896	$ 481	$ 3,457	$ 114,920
December 31, 2013				
Mortgage-backed	$ 953	$ 128	$ -	$ 1,081
Collateralized mortgage obligations	62,025	-	4,569	57,456
State & municipal	54,305	442	8	54,739
Total securities held to maturity	$ 117,283	$ 570	$ 4,577	$ 113,276

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The following table sets forth information with regard to investment securities with unrealized losses at March 31, 2014 and December 31, 2013:

Security Type:	Less than 12 months Fair Value	Unrealized losses	Number of Positions	12 months or longer Fair Value	Unrealized losses	Number of Positions	Total Fair Value	Unrealized losses	Number of Positions
March 31, 2014 Investment securities available for sale:									
Federal agency	$245,397	$(5,221)	21	$9,704	$(296)	1	$255,101	$(5,517)	22
State & municipal	48,377	(839)	171	934	(16)	3	49,311	(855)	174
Mortgage-backed	1,110,605	(1,465)	58	960	(10)	4	1,111,565	(1,475)	62
Collateralized mortgage obligations	295,408	(10,516)	31	60,681	(3,012)	4	356,089	(13,528)	35
Other securities	5,507	(186)	2	198	(50)	1	5,705	(236)	3
Total securities with unrealized losses	$1,705,294	$(18,227)	283	$72,477	$(3,384)	13	$1,777,771	$(21,611)	296
March 31, 2014 Investment securities held to maturity:									
Collateralized mortgage obligations	$57,528	$(3,444)	5	$-	$-	-	$57,528	$(3,444)	5
State & municipal	2,120	(13)	3	-	-	-	2,120	(13)	3
Total securities with unrealized losses	$59,648	$(3,457)	8	$-	$-	-	$59,648	$(3,457)	8
December 31, 2013 Investment securities available for sale:									
Federal agency	$233,935	$(6,927)	20	$9,619	$(381)	1	$243,554	$(7,308)	21
State & municipal	50,328	(1,612)	177	-	-	-	50,328	(1,612)	177
Mortgage-backed	143,080	(2,216)	79	-	-	-	143,080	(2,216)	79
Collateralized mortgage obligations	379,273	(18,243)	36	-	-	-	379,273	(18,243)	36
Other securities	5,490	(203)	2	223	(25)	1	5,713	(228)	3
Total securities with unrealized losses	$812,106	$(29,201)	314	$9,842	$(406)	2	$821,948	$(29,607)	316
December 31, 2013 Investment securities held to maturity:									
Collateralized mortgage obligations	$57,456	$(4,569)	5	$-	$-	-	$57,456	$(4,569)	5
State & municipal	1,012	(8)	1	-	-	-	1,012	(8)	1
Total securities with unrealized losses	$58,468	$(4,577)	6	$-	$-	-	$58,468	$(4,577)	6

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Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses or in other comprehensive income, depending on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If the Company does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment shall be separated into (a) the amount representing the credit loss and (b) the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss shall be recognized in earnings. The amount of the total other-than-temporary impairment related to other factors shall be recognized in other comprehensive income, net of applicable taxes.

In estimating other-than-temporary impairment losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the historical and implied volatility of the fair value of the security.

Management has the intent to hold the securities classified as held to maturity until they mature, at which time it is believed the Company will receive full value for the securities. Furthermore, as of March 31, 2014, management also had the intent to hold, and will not be required to sell, the securities classified as available for sale for a period of time sufficient for a recovery of cost, which may be until maturity. The unrealized losses are due to increases in market interest rates over the yields available at the time the underlying securities were purchased. When necessary, the Company has performed a discounted cash flow analysis to determine whether or not it will receive the contractual principal and interest on certain securities. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. As of March 31, 2014, management believes the impairments detailed in the table above are temporary and no other-than-temporary impairment losses have been realized in the Company's consolidated statements of income.

The following tables set forth information with regard to contractual maturities of debt securities at March 31, 2014:

(In thousands)	Amortized cost	Estimated fair value
Debt securities classified as available for sale		
Within one year	$27,461	$27,627
From one to five years	302,113	301,603
From five to ten years	259,225	259,821
After ten years	782,201	773,080
	$1,371,000	$1,362,131
Debt securities classified as held to maturity		
Within one year	$24,714	$24,765
From one to five years	21,654	21,957
From five to ten years	8,401	8,395
After ten years	63,127	59,803
	$117,896	$114,920

Maturities of mortgage-backed, collateralized mortgage obligations and asset-backed securities are stated based on their estimated average lives. Actual maturities may differ from estimated average lives or contractual maturities because, in certain cases, borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

Except for U.S. Government securities, there were no holdings, when taken in the aggregate, of any single issuer that exceeded 10% of consolidated stockholders' equity at March 31, 2014.

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Note 4. Allowance for Loan Losses and Credit Quality of Loans

Allowance for Loan Losses

The allowance for loan losses is maintained at a level estimated by management to provide adequately for risk of probable losses inherent in the current loan portfolio. The adequacy of the allowance for loan losses is continuously monitored. It is assessed for adequacy using a methodology designed to ensure the level of the allowance reasonably reflects the loan portfolio's risk profile. It is evaluated to ensure that it is sufficient to absorb all reasonably estimable credit losses inherent in the current loan portfolio.

To develop and document a systematic methodology for determining the allowance for loan losses, the Company has divided the loan portfolio into three segments, each with different risk characteristics and methodologies for assessing risk. Those segments are further segregated between our loans accounted for under the amortized cost method (referred to as "originated" loans) and loans acquired in a business combination (referred to as "acquired" loans). Each portfolio segment is broken down into class segments where appropriate. Class segments contain unique measurement attributes, risk characteristics and methods for monitoring and assessing risk that are necessary to develop the allowance for loan losses. Unique characteristics such as borrower type, loan type, collateral type, and risk characteristics define each class segment. The following table illustrates the portfolio and class segments for the Company's loan portfolio:

Portfolio	Class
Commercial Loans	Commercial
	Commercial Real Estate
	Agricultural
	Agricultural Real Estate
	Business Banking
Consumer Loans	Indirect
	Home Equity
	Direct
Residential Real Estate Mortgages	

Commercial Loans

The Company offers a variety of commercial loan products including commercial (non-real estate), commercial real estate, agricultural, agricultural real estate, and business banking loans. The Company's underwriting analysis for commercial loans typically includes credit verification, independent appraisals, a review of the borrower's financial condition, and a detailed analysis of the borrower's underlying cash flows.

Commercial – The Company offers a variety of loan options to meet the specific needs of our commercial customers including term loans, time notes and lines of credit. Such loans are made available to businesses for working capital needs such as inventory and receivables, business expansion and equipment purchases. Generally, a collateral lien is placed on equipment or other assets owned by the borrower. These loans carry a higher risk than commercial real estate loans due to the nature of the underlying collateral, which can be business assets such as equipment and accounts receivable. To reduce the risk, management also attempts to secure real estate as collateral and obtain personal guarantees of the borrowers.

Commercial Real Estate – The Company offers commercial real estate loans to finance real estate purchases, refinancings, expansions and improvements to commercial properties. Commercial real estate loans are made to finance the purchases of real estate, generally with completed structures. These commercial real estate loans are secured by first liens on the real estate, which may include apartments, commercial structures, housing businesses, healthcare facilities, and other non owner-occupied facilities. These loans are typically less risky than commercial loans, since they are secured by real estate and buildings, and are generally originated in amounts of no more than 80% of the appraised value of the property.

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Agricultural – The Company offers a variety of agricultural loans to meet the needs of our agricultural customers including term loans, time notes, and lines of credit. These loans are made to purchase livestock, purchase and modernize equipment, and finance seasonal crop expenses. Generally, a collateral lien is placed on the livestock, equipment, produce inventories, and/or receivables owned by the borrower. These loans may carry a higher risk than commercial and agricultural real estate loans due to the industry price volatility, and in some cases, the perishable nature of the underlying collateral. To reduce these risks, management may attempt to secure these loans with additional real estate collateral, obtain personal guarantees of the borrowers, or obtain government loan guarantees to provide further support.

Agricultural Real Estate – The Company offers real estate loans to our agricultural customers to finance farm related real estate purchases, refinancings, expansions, and improvements to agricultural properties such as barns, production facilities, and land. The agricultural real estate loans are secured by first liens on the farm real estate. Because they are secured by land and buildings, these loans may be less risky than agricultural loans. These loans are typically originated in amounts of no more than 75% of the appraised value of the property. Government loan guarantees may be obtained to provide further support.

Business Banking - The Company offers a variety of loan options to meet the specific needs of our business banking customers including term loans, business banking mortgages and lines of credit. Such loans are generally less than $0.5 million and are made available to businesses for working capital such as inventory and receivables, business expansion, equipment purchases, and agricultural needs. Generally, a collateral lien is placed on equipment or other assets owned by the borrower such as inventory and/or receivables. These loans carry a higher risk than commercial loans due to the smaller size of the borrower and lower levels of capital. To reduce the risk, the Company obtains personal guarantees of the owners for a majority of the loans.

Consumer Loans

The Company offers a variety of consumer loan products including indirect, home equity, and direct loans.

Indirect – The Company maintains relationships with many dealers primarily in the communities that we serve. Through these relationships, the company primarily finances the purchases of automobiles and recreational vehicles (such as campers, boats, etc.) indirectly through dealer relationships. Approximately 75% of the indirect relationships represent automobile financing. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from three to six years, based upon the nature of the collateral and the size of the loan. The majority of indirect consumer loans are underwritten on a secured basis using the underlying collateral being financed.

Home Equity – The Company offers fixed home equity loans as well as home equity lines of credit to consumers to finance home improvements, debt consolidation, education and other uses. Consumers are able to borrow up to 85% of the equity in their homes. The Company originates home equity lines of credit and second mortgage loans (loans secured by a second junior lien position on one-to-four-family residential real estate). These loans carry a higher risk than first mortgage residential loans as they are in a second position with respect to collateral. Risk is reduced through underwriting criteria, which include credit verification, appraisals, a review of the borrower's financial condition, and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate.

Direct – The Company offers a variety of consumer installment loans to finance vehicle purchases, mobile home purchases and personal expenditures. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from one to ten years, based upon the nature of the collateral and the size of the loan. The majority of consumer loans are underwritten on a secured basis using the underlying collateral being financed or a customer's deposit account. In addition to installment loans, the Company also offers personal lines of credit and overdraft protection. A minimal amount of loans are unsecured, which carry a higher risk of loss.

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Residential Real Estate Mortgages

Residential real estate loans consist primarily of loans secured by first or second deeds of trust on primary residences. We originate adjustable-rate and fixed-rate, one-to-four-family residential real estate loans for the construction, purchase or refinancing of a mortgage. These loans are collateralized by owner-occupied properties located in the Company's market area. Loans on one-to-four-family residential real estate are generally originated in amounts of no more than 85% of the purchase price or appraised value (whichever is lower), or have private mortgage insurance. The Company's underwriting analysis for residential mortgage loans typically includes credit verification, independent appraisals, and a review of the borrower's financial condition. Mortgage title insurance and hazard insurance are normally required. Construction loans have a unique risk, because they are secured by an incomplete dwelling. This risk is reduced through periodic site inspections, including one at each loan draw period.

For purposes of evaluating the adequacy of the allowance, the Company considers a number of significant factors that affect the collectability of the portfolio. For individually analyzed loans, these include estimates of loss exposure, which reflect the facts and circumstances that affect the likelihood of repayment of such loans as of the evaluation date. For homogeneous pools of loans, estimates of the Company's exposure to credit loss reflect a current assessment of a number of factors, which could affect collectability. These factors include: past loss experience; size, trend, composition, and nature of loans; changes in lending policies and procedures, including underwriting standards and collection, charge-offs and recoveries; trends experienced in nonperforming and delinquent loans; current economic conditions in the Company's market; portfolio concentrations that may affect loss experienced across one or more components of the portfolio; the effect of external factors such as competition, legal and regulatory requirements; and the experience, ability, and depth of lending management and staff. In addition, various regulatory agencies, as an integral component of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to make loan grade changes as well as recognize additions to the allowance based on their examinations.

After a thorough consideration of the factors discussed above, any required additions or reductions to the allowance for loan losses are made periodically by charges or credits to the provision for loan losses. These charges or credits are necessary to maintain the allowance at a level which management believes is reasonably reflective of overall inherent risk of probable loss in the portfolio. While management uses available information to recognize losses on loans, additions and reductions of the allowance may fluctuate from one reporting period to another. These fluctuations are reflective of changes in risk associated with portfolio content and/or changes in management's assessment of any or all of the determining factors discussed above.

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The following tables illustrate the changes in the allowance for loan losses by our portfolio segments for the three months ended March 31, 2014 and 2013:

Three months ended March 31	Commercial Loans	Consumer Loans	Residential Real Estate Mortgages	Unallocated	Total
Balance as of December 31, 2013	$ 35,090	$ 27,694	$ 6,520	$ 130	$69,434
Charge-offs	(479)	(4,032)	(319)	-	(4,830)
Recoveries	399	741	94	-	1,234
Provision	(573)	4,033	(70)	206	3,596
Ending Balance as of March 31, 2014	$ 34,437	$ 28,436	$ 6,225	$ 336	$69,434
Balance as of December 31, 2012	$ 35,624	$ 27,162	$ 6,252	$ 296	$69,334
Charge-offs	(3,322)	(3,723)	(671)	-	(7,716)
Recoveries	467	977	14	-	1,458
Provision	2,589	1,869	1,113	87	5,658
Ending Balance as of March 31, 2013	$ 35,358	$ 26,285	$ 6,708	$ 383	$68,734

For acquired loans, to the extent that we experience deterioration in borrower credit quality resulting in a decrease in our expected cash flows subsequent to acquisition of the loans, an allowance for loan losses would be established based on our estimate of future credit losses over the remaining life of the loans. As of March 31, 2014 and 2013, there was no allowance for loan losses for the acquired loan portfolio. Net charge-offs related to acquired loans totaled approximately $0.2 million during the three months ended March 31, 2014 and 2013, and are included in the table above.

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The following tables illustrate the allowance for loan losses and the recorded investment by portfolio segments as of March 31, 2014 and December 31, 2013:

Allowance for Loan Losses and Recorded Investment in Loans
(in thousands)

	Commercial Loans	Consumer Loans	Residential Real Estate Mortgages	Unallocated	Total
As of March 31, 2014					
Allowance for loan losses	$34,437	$28,436	$6,225	$ 336	$69,434
Allowance for loans individually evaluated for impairment	925	-	-		925
Allowance for loans collectively evaluated for impairment	$33,512	$28,436	$6,225	$ 336	$68,509
Ending balance of loans	$2,436,202	$1,989,030	$1,056,793		$5,482,025
Ending balance of originated loans individually evaluated for impairment	15,025	4,248	2,722		21,995
Ending balance of acquired loans individually evaluated for impairment	9,873	-	-		9,873
Ending balance of acquired loans collectively evaluated for impairment	385,669	199,196	300,360		885,225
Ending balance of originated loans collectively evaluated for impairment	$2,025,635	$1,785,586	$753,711		$4,564,932
As of December 31, 2013					
Allowance for loan losses	$35,090	$27,694	$6,520	$ 130	$69,434
Allowance for loans individually evaluated for impairment	715	-	-		715
Allowance for loans collectively evaluated for impairment	$34,375	$27,694	$6,520	$ 130	$68,719
Ending balance of loans	$2,392,621	$1,972,537	$1,041,637		$5,406,795
Ending balance of originated loans individually evaluated for impairment	16,120	3,248	2,012		21,380
Ending balance of acquired loans individually evaluated for impairment	10,060	-	-		10,060
Ending balance of acquired loans collectively evaluated for impairment	392,329	219,587	308,416		920,332
	$1,974,112	$1,749,702	$731,209		$4,455,023

Ending balance of originated loans collectively evaluated for impairment

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Credit Quality of Loans

Loans are placed on nonaccrual status when timely collection of principal and interest in accordance with contractual terms is doubtful. Loans are transferred to nonaccrual status generally when principal or interest payments become ninety days delinquent, unless the loan is well secured and in the process of collection, or sooner when management concludes or circumstances indicate that borrowers may be unable to meet contractual principal or interest payments. When a loan is transferred to a nonaccrual status, all interest previously accrued in the current period but not collected is reversed against interest income in that period. Interest accrued in a prior period and not collected is charged-off against the allowance for loan losses. The Company's nonaccrual policies are the same for all classes of financing receivable.

If ultimate repayment of a nonaccrual loan is expected, any payments received are applied in accordance with contractual terms. If ultimate repayment of principal is not expected, any payment received on a nonaccrual loan is applied to principal until ultimate repayment becomes expected. Nonaccrual loans are returned to accrual status when they become current as to principal and interest and demonstrate a period of performance under the contractual terms and, in the opinion of management, are fully collectible as to principal and interest. When in the opinion of management the collection of principal appears unlikely, the loan balance is charged-off in total or in part. For loans in all portfolios, the principal amount is charged off in full or in part as soon as management determines, based on available facts, that the collection of principal in full is improbable. For commercial loans, management considers specific facts and circumstances relative to individual credits in making such a determination. For consumer and residential loan classes, management uses specific guidance and thresholds from the Federal Financial Institutions Examination Council's Uniform Retail Credit Classification and Account Management Policy.

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The following table illustrates the Company's nonaccrual loans by loan class:

Loans on Nonaccrual Status as of:

(In thousands)	March 31, 2014	December 31, 2013
ORIGINATED		
Commercial Loans		
Commercial	$3,644	$ 3,669
Commercial Real Estate	7,282	7,834
Agricultural	1,366	1,135
Agricultural Real Estate	1,758	961
Business Banking	5,708	5,701
	19,758	19,300
Consumer Loans		
Indirect	1,549	1,461
Home Equity	7,074	5,931
Direct	76	86
	8,699	7,478
Residential Real Estate Mortgages	6,905	7,105
	$35,362	$ 33,883
ACQUIRED		
Commercial Loans		
Commercial	$6,477	$ 6,599
Commercial Real Estate	3,493	3,559
Business Banking	1,037	1,340
	11,007	11,498
Consumer Loans		
Indirect	129	93
Home Equity	808	570
Direct	38	49
	975	712
Residential Real Estate Mortgages	4,120	3,872
	$16,102	$ 16,082
TOTAL NONACCRUAL LOANS	$51,464	$ 49,965

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The following tables set forth information with regard to past due and nonperforming loans by loan class as of March 31, 2014 and December 31, 2013:

Age Analysis of Past Due Financing Receivables
As of March 31, 2014
(in thousands)

	31-60 Days Past Due Accruing	61-90 Days Past Due Accruing	Greater Than 90 Days Past Due Accruing	Total Past Due Accruing	Non-Accrual	Current	Recorded Total Loans
ORIGINATED							
Commercial Loans							
Commercial	$ -	$ 409	$ -	$ 409	$ 3,644	$ 631,041	$ 635,094
Commercial Real Estate	367	69	-	436	7,282	959,156	966,874
Agricultural	-	-	-	-	1,366	60,979	62,345
Agricultural Real Estate	136	-	-	136	1,758	36,719	38,613
Business Banking	1,151	159	158	1,468	5,708	330,558	337,734
	1,654	637	158	2,449	19,758	2,018,453	2,040,660
Consumer Loans							
Indirect	9,189	2,061	1,286	12,536	1,549	1,203,341	1,217,426
Home Equity	5,403	2,032	583	8,018	7,074	502,372	517,464
Direct	413	90	52	555	76	54,313	54,944
	15,005	4,183	1,921	21,109	8,699	1,760,026	1,789,834
Residential Real Estate Mortgages	3,307	1,076	444	4,827	6,905	744,701	756,433
	$ 19,966	$ 5,896	$ 2,523	$ 28,385	$ 35,362	$ 4,523,180	$ 4,586,927
ACQUIRED							
Commercial Loans							
Commercial	$ 150	$ -	$ -	$ 150	$ 6,477	$ 97,406	$ 104,033
Commercial Real Estate	-	-	-	-	3,493	219,524	223,017
Business Banking	45	-	-	45	1,037	67,410	68,492
	195	-	-	195	11,007	384,340	395,542
Consumer Loans							
Indirect	575	84	50	709	129	107,501	108,339
Home Equity	288	93	112	493	808	83,044	84,345
Direct	99	8	15	122	38	6,352	6,512
	962	185	177	1,324	975	196,897	199,196
Residential Real Estate Mortgages	1,329	39	-	1,368	4,120	294,872	300,360
	$ 2,486	$ 224	$ 177	$ 2,887	$ 16,102	$ 876,109	$ 895,098
Total Loans	$ 22,452	$ 6,120	$ 2,700	$ 31,272	$ 51,464	$ 5,399,289	$ 5,482,025

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Age Analysis of Past Due Financing Receivables
As of December 31, 2013
(in thousands)

	31-60 Days Past Due Accruing	61-90 Days Past Due Accruing	Greater Than 90 Days Past Due Accruing	Total Past Due Accruing	Non-Accrual	Current	Recorded Total Loans
ORIGINATED							
Commercial Loans							
Commercial	$ 105	$ 247	$ -	$ 352	$ 3,669	$ 612,402	$ 616,423
Commercial Real Estate	1,366	-	-	1,366	7,834	925,116	934,316
Agricultural	150	21	-	171	1,135	63,856	65,162
Agricultural Real Estate	519	-	-	519	961	35,172	36,652
Business Banking	1,228	122	105	1,455	5,701	330,523	337,679
	3,368	390	105	3,863	19,300	1,967,069	1,990,232
Consumer Loans							
Indirect	14,093	2,878	1,583	18,554	1,461	1,141,829	1,161,844
Home Equity	6,033	1,888	1,115	9,036	5,931	517,856	532,823
Direct	679	125	46	850	86	57,347	58,283
	20,805	4,891	2,744	28,440	7,478	1,717,032	1,752,950
Residential Real Estate Mortgages	3,951	379	808	5,138	7,105	720,978	733,221
	$ 28,124	$ 5,660	$ 3,657	$ 37,441	$ 33,883	$ 4,405,079	$ 4,476,403
ACQUIRED							
Commercial Loans							
Commercial	$ 24	$ -	$ -	$ 24	$ 6,599	$ 96,603	$ 103,226
Commercial Real Estate	-	-	-	-	3,559	225,455	229,014
Business Banking	320	2	-	322	1,340	68,487	70,149
	344	2	-	346	11,498	390,545	402,389
Consumer Loans							
Indirect	939	113	71	1,123	93	123,870	125,086
Home Equity	753	63	-	816	570	85,690	87,076
Direct	76	56	9	141	49	7,235	7,425
	1,768	232	80	2,080	712	216,795	219,587
Residential Real Estate Mortgages	1,725	-	-	1,725	3,872	302,819	308,416
	$ 3,837	$ 234	$ 80	$ 4,151	$ 16,082	$ 910,159	$ 930,392
Total Loans	$ 31,961	$ 5,894	$ 3,737	$ 41,592	$ 49,965	$ 5,315,238	$ 5,406,795

There were no material commitments to extend further credit to borrowers with nonperforming loans.

Impaired Loans

The methodology used to establish the allowance for loan losses on impaired loans incorporates specific allocations on loans analyzed individually. Classified and nonperforming loans and troubled debt restructured loans ("TDR") with outstanding balances of $0.5 million or more are evaluated for impairment through the Company's quarterly status review process. In determining that we will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreements, we consider factors such as payment history and changes in the financial condition of individual borrowers, local economic conditions, historical loss experience and the conditions of the various markets in which the collateral may be liquidated. For loans that are impaired as defined by accounting standards, impairment is measured by one of three methods: 1) the fair value of collateral less cost to sell, 2) present value of expected future cash flows or 3) the loan's observable market price. All impaired loans are reviewed on a quarterly basis for changes in the measurement of impairment. Any change to the previously recognized impairment loss is recognized as a change to the allowance account and recorded in the consolidated statement of income as a component of the provision for credit losses.

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The following table provides information on loans specifically evaluated for impairment as of March 31, 2014 and December 31, 2013:

	March 31, 2014			December 31, 2013		
(in thousands)	Recorded Investment Balance (Book)	Unpaid Principal Balance (Legal)	Related Allowance	Recorded Investment Balance (Book)	Unpaid Principal Balance (Legal)	Related Allowance
ORIGINATED						
With no related allowance recorded:						
Commercial Loans						
Commercial	$2,026	$2,096		$4,721	$4,777	
Commercial Real Estate	7,252	7,823		4,613	5,164	
Agricultural	124	195		125	195	
Agricultural Real Estate	1,418	1,697		1,431	1,708	
Business Banking	172	564		210	602	
Total Commercial Loans	10,992	12,375		11,100	12,446	
Consumer Loans						
Home Equity	4,248	4,534		3,248	3,472	
Residential Real Estate Mortgages	2,722	3,036		2,012	2,255	
Total	17,962	19,945		16,360	18,173	
With an allowance recorded:						
Commercial Loans						
Commercial Real Estate	4,033	5,890	925	5,020	6,877	715
ACQUIRED						
With no related allowance recorded:						
Commercial Loans						
Commercial	6,380	6,538		6,501	6,538	
Commercial Real Estate	3,493	3,842		3,559	3,842	
Total Commercial Loans	9,873	10,380		10,060	10,380	
Total:	$31,868	$36,215	$ 925	$31,440	$35,430	$ 715

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The following tables summarize the average recorded investments on impaired loans specifically evaluated for impairment and the interest income recognized for the three ended March 31, 2014 and 2013:

	For the three months ended			
	March 31, 2014		March 31, 2013	
(in thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
ORIGINATED				
Commercial Loans				
Commercial	$2,038	$ -	$5,069	$ 29
Commercial Real Estate	11,553	42	12,339	72
Agricultural	125	-	378	3
Agricultural Real Estate	1,424	12	900	12
Business Banking	185	12	80	-
Consumer Loans				
Home Equity	4,282	43	2,901	29
Residential Real Estate Mortgage	2,727	23	2,065	11
Total Originated	$22,334	$ 132	$23,732	$ 156
ACQUIRED				
Commercial Loans				
Commercial	6,436	-	-	-
Commercial Real Estate	3,524	-	-	-
TotalAcquired	$9,960	$ -	$-	$ -
Total Loans	$32,294	$ 132	$23,732	$ 156

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Credit Quality Indicators

The Company has developed an internal loan grading system to evaluate and quantify the Company's loan portfolio with respect to quality and risk. The system focuses on, among other things, financial strength of borrowers, experience and depth of borrower's management, primary and secondary sources of repayment, payment history, nature of the business, and outlook on particular industries. The internal grading system enables the Company to monitor the quality of the entire loan portfolio on a consistent basis and provide management with an early warning system, enabling recognition and response to problem loans and potential problem loans.

Commercial Grading System

For commercial and agricultural loans, the Company uses a grading system that relies on quantifiable and measurable characteristics when available. This would include comparison of financial strength to available industry averages, comparison of transaction factors (loan terms and conditions) to loan policy, and comparison of credit history to stated repayment terms and industry averages. Some grading factors are necessarily more subjective such as economic and industry factors, regulatory environment, and management. Classified commercial loans consist of loans graded substandard and below. The grading system for commercial and agricultural loans is as follows:

· Doubtful

A doubtful loan has a high probability of total or substantial loss, but because of specific pending events that may strengthen the asset, its classification as a loss is deferred. Doubtful borrowers are usually in default, lack adequate liquidity or capital, and lack the resources necessary to remain an operating entity. Pending events can include mergers, acquisitions, liquidations, capital injections, the perfection of liens on additional collateral, the valuation of collateral, and refinancing. Generally, pending events should be resolved within a relatively short period and the ratings will be adjusted based on the new information. Nonaccrual treatment is required for doubtful assets because of the high probability of loss.

· Substandard

Substandard loans have a high probability of payment default, or they have other well-defined weaknesses. They require more intensive supervision by bank management. Substandard loans are generally characterized by current or expected unprofitable operations, inadequate debt service coverage, inadequate liquidity, or marginal capitalization. Repayment may depend on collateral or other credit risk mitigants. For some Substandard loans, the likelihood of full collection of interest and principal may be in doubt and those loans should be placed on nonaccrual. Although Substandard assets in the aggregate will have a distinct potential for loss, an individual asset's loss potential does not have to be distinct for the asset to be rated Substandard.

· Special Mention

Special Mention loans have potential weaknesses that may, if not checked or corrected, weaken the asset or inadequately protect the Company's position at some future date. These loans pose elevated risk, but their weakness does not yet justify a Substandard classification. Borrowers may be experiencing adverse operating trends (declining revenues or margins) or may be struggling with an ill-proportioned balance sheet (e.g., increasing inventory without an increase in sales, high leverage, tight liquidity). Adverse economic or market conditions, such as interest rate increases or the entry of a new competitor, may also support a Special Mention rating. Although a Special Mention loan has a higher probability of default than a pass asset, its default is not imminent.

· Pass

Loans graded as Pass encompass all loans not graded as Doubtful, Substandard, or Special Mention. Pass loans are in compliance with loan covenants, and payments are generally made as agreed. Pass loans range from superior quality to fair quality.

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Business Banking Grading System
Business banking loans are graded as either Classified or Non-classified:

· Classified
Classified loans are inadequately protected by the current worth and paying capacity of the obligor or, if applicable, the collateral pledged. These loans have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt, or in some cases make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Classified loans have a high probability of payment default, or a high probability of total or substantial loss. These loans require more intensive supervision by management and are generally characterized by current or expected unprofitable operations, inadequate debt service coverage, inadequate liquidity, or marginal capitalization. Repayment may depend on collateral or other credit risk mitigants. When the likelihood of full collection of interest and principal may be in doubt; classified loans are considered to have a nonaccrual status. In some cases, Classified loans are considered uncollectible and of such little value that their continuance as assets is not warranted.

· Non-classified
Loans graded as Non-classified encompass all loans not graded as Classified. Non-classified loans are in compliance with loan covenants, and payments are generally made as agreed.

Consumer and Residential Mortgage Grading System
Consumer and Residential Mortgage loans are graded as either Performing or Nonperforming. Nonperforming loans are loans that are 1) over 90 days past due and interest is still accruing, 2) on nonaccrual status or 3) restructured. All loans not meeting any of these three criteria are considered Performing.

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The following tables illustrate the Company's credit quality by loan class as of March 31, 2014 and December 31, 2013:

Credit Quality Indicators
As of March 31, 2014

ORIGINATED

Commercial Credit Exposure By Internally Assigned Grade:	Commercial	Commercial Real Estate	Agricultural	Agricultural Real Estate	Total
Pass	$ 585,553	$ 910,431	$ 57,573	$ 34,754	$ 1,588,311
Special Mention	12,755	20,924	366	7	34,052
Substandard	36,786	35,519	4,394	3,852	80,551
Doubtful	-	-	12	-	12
Total	$ 635,094	$ 966,874	$ 62,345	$ 38,613	$ 1,702,926

Business Banking Credit Exposure By Internally Assigned Grade:	Business Banking	Total
Non-classified	$ 319,727	$ 319,727
Classified	18,007	18,007
Total	$ 337,734	$ 337,734

Consumer Credit Exposure By Payment Activity:	Indirect	Home Equity	Direct	Total
Performing	$ 1,214,591	$ 509,807	$ 54,816	$ 1,779,214
Nonperforming	2,835	7,657	128	10,620
Total	$ 1,217,426	$ 517,464	$ 54,944	$ 1,789,834

Residential Mortgage Credit Exposure By Payment Activity:	Residential Mortgage	Total
Performing	$ 749,084	$ 749,084
Nonperforming	7,349	7,349
Total	$ 756,433	$ 756,433

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Credit Quality Indicators
As of March 31, 2014

ACQUIRED

Commercial Credit Exposure By Internally Assigned Grade:	Commercial	Commercial Real Estate	Agricultural	Total
Pass	$ 88,439	$ 204,582	$ -	$293,021
Special Mention	2,010	2,699	-	4,709
Substandard	13,584	15,736	-	29,320
Doubtful	-	-	-	-
Total	$ 104,033	$ 223,017	$ -	$327,050

Business Banking Credit Exposure By Internally Assigned Grade:	Business Banking	Total
Non-classified	$ 63,332	$63,332
Classified	5,160	5,160
Total	$ 68,492	$68,492

Consumer Credit Exposure By Payment Activity:	Indirect	Home Equity	Direct	Total
Performing	$ 108,160	$ 83,425	$ 6,459	$198,044
Nonperforming	179	920	53	1,152
Total	$ 108,339	$ 84,345	$ 6,512	$199,196

Residential Mortgage Credit Exposure By Payment Activity:	Residential Mortgage	Total
Performing	$ 296,240	$296,240
Nonperforming	4,120	4,120
Total	$ 300,360	$300,360

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Credit Quality Indicators
As of December 31, 2013

ORIGINATED

Commercial Credit Exposure By Internally Assigned Grade:	Commercial	Commercial Real Estate	Agricultural	Agricultural Real Estate	Total
Pass	$ 576,079	$ 878,411	$ 60,043	$ 33,136	$ 1,547,669
Special Mention	16,836	22,777	381	43	40,037
Substandard	23,508	33,128	4,726	3,473	64,835
Doubtful	-	-	12	-	12
Total	$ 616,423	$ 934,316	$ 65,162	$ 36,652	$ 1,652,553

Business Banking Credit Exposure

By Internally Assigned Grade:	Business Banking	Total
Non-classified	$ 319,578	$ 319,578
Classified	18,101	18,101
Total	$ 337,679	$ 337,679

Consumer Credit Exposure

By Payment Activity:	Indirect	Home Equity	Direct	Total
Performing	$ 1,158,800	$ 525,777	$ 58,151	$ 1,742,728
Nonperforming	3,044	7,046	132	10,222
Total	$ 1,161,844	$ 532,823	$ 58,283	$ 1,752,950

Residential Mortgage Credit Exposure By Payment Activity:	Residential Mortgage	Total
Performing	$ 725,308	$ 725,308
Nonperforming	7,913	7,913
Total	$ 733,221	$ 733,221

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Credit Quality Indicators
As of December 31, 2013

ACQUIRED

Commercial Credit Exposure By Internally Assigned Grade:	Commercial	Commercial Real Estate	Agricultural	Total
Pass	$ 85,692	$ 205,010	$ -	$290,702
Special Mention	2,230	6,183	-	8,413
Substandard	15,304	17,821	-	33,125
Doubtful	-	-	-	-
Total	$ 103,226	$ 229,014	$ -	$332,240

Business Banking Credit Exposure By Internally Assigned Grade:	Business Banking	Total
Non-classified	$ 65,437	$65,437
Classified	4,712	4,712
Total	$ 70,149	$70,149

Consumer Credit Exposure By Payment Activity:	Indirect	Home Equity	Direct	Total
Performing	$ 124,922	$ 86,506	$ 7,367	$218,795
Nonperforming	164	570	58	792
Total	$ 125,086	$ 87,076	$ 7,425	$219,587

Residential Mortgage Credit Exposure By Payment Activity:	Residential Mortgage	Total
Performing	$ 304,544	$304,544
Nonperforming	3,872	3,872
Total	$ 308,416	$308,416

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Troubled Debt Restructured Loans

The Company’s loan portfolio includes certain loans that have been modified where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Company’s loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower’s sustained repayment performance for a reasonable period, generally six months. Substantially all of these modifications included one or a combination of the following: an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; temporary reduction in the interest rate; or change in scheduled payment amount.

When the Company modifies a loan, management evaluates any possible impairment based on the present value of the expected future cash flows, discounted at the contractual interest rate of the original loan agreement, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases, management uses the current fair value of the collateral, less selling costs, instead of discounted cash flows. If management determines that the value of the modified loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized by segment or class of loan as applicable, through an allowance estimate or a charge-off to the allowance. Segment and class status is determined by the loan’s classification at origination.

TDRs that occurred during the three month period ending March 31, 2014 consisted of 22 home equity loans and 12 residential real estate mortgages totaling $1.1 million and $1.0 million, respectively. For all such modifications, the pre and post outstanding recorded investment amount remained unchanged. During the three month period ending March 31, 2014 there was one default on a home equity loan totaling $11,000 and one default on a residential real estate mortgage totaling $0.1 million.

TDRs that occurred during the three month period ending March 31, 2013 consisted of 10 home equity loans and one residential real estate mortgage totaling $0.6 million and $0.1 million, respectively. For all such modifications, the pre and post outstanding recorded investment amount remained unchanged. During the three month period ending March 31, 2013 there were no defaults on previously modified loans.

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Note 5. Defined Benefit Postretirement Plans

The Company has a qualified, noncontributory, defined benefit pension plan ("the Plan") covering substantially all of its employees at March 31, 2014. Benefits paid from the plan are based on age, years of service, compensation and social security benefits, and are determined in accordance with defined formulas. The Company's policy is to fund the pension plan in accordance with Employee Retirement Income Security Act of 1974 ("ERISA") standards. Assets of the plan are invested in publicly traded stocks and bonds. The Company is not required to make contributions to the Plan in 2014, and did not do so during the three months ended March 31, 2014.

The Company assumed a noncontributory, defined benefit pension plan in the Alliance acquisition. This plan covers certain Alliance full-time employees who met eligibility requirements on October 6, 2006, at which time all benefits were frozen. Under the plan, retirement benefits are primarily a function of both the years of service and the level of compensation. Effective May 1, 2013, this plan was merged into the Plan.

Market conditions can result in an unusually high degree of volatility and increase the risks and short term liquidity associated with certain investments held by the Plan which could impact the value of these investments.

In addition to the Plan, the Company also provides supplemental employee retirement plans to certain current and former executives. These supplemental employee retirement plans and the Plan are collectively referred to herein as "Pension Benefits."

Also, the Company provides certain health care benefits for retired employees. Benefits are accrued over the employees' active service period. Only employees that were employed by the Company on or before January 1, 2000 are eligible to receive postretirement health care benefits. This health care benefits plan is contributory for participating retirees, requiring participants to absorb certain deductibles and coinsurance amounts with contributions adjusted annually to reflect cost sharing provisions and benefit limitations called for in the plan. Eligibility is contingent upon the direct transition from active employment status to retirement without any break in employment from the Company. Employees also must be participants in the Company's medical plan prior to their retirement. The Company funds the cost of postretirement health care as benefits are paid. The Company elected to recognize the transition obligation on a delayed basis over twenty years. In addition, the Company assumed post-retirement medical life insurance benefits for certain Alliance employees, retirees and their spouses, if applicable, in the Alliance acquisition. These postretirement benefits are referred to herein as "Other Benefits." The components of expense for Pension Benefits and Other Benefits are set forth below (in thousands):

	Pension Benefits		Other Benefits	
	Three months ended March 31,		Three months ended March 31,	
Components of net periodic (benefit) cost:	2014	2013	2014	2013
Service cost	$587	$604	$4	$6
Interest cost	1,040	722	90	34
Expected return on plan assets	(2,175)	(1,825)	-	-
Net amortization	25	603	(6)	223
Total (benefit) cost	$(523)	$104	$88	$263

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Note 6. Earnings Per Share

Basic earnings per share excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity (such as the Company's dilutive stock options and restricted stock units).

The following is a reconciliation of basic and diluted earnings per share for the periods presented in the consolidated statements of income.

Three months ended March 31,	2014	2013
(in thousands, except per share data)		
Basic EPS:		
Weighted average common shares outstanding	43,762	36,410
Net income available to common shareholders	18,009	7,649
Basic EPS	$0.41	$0.21
Diluted EPS:		
Weighted average common shares outstanding	43,762	36,410
Dilutive effect of common stock options and restricted stock	505	384
Weighted average common shares and common share equivalents	44,267	36,794
Net income available to common shareholders	18,009	7,649
Diluted EPS	$0.41	$0.21

There were 479,543 stock options for the quarter ended March 31, 2014 and 1,171,825 stock options for the quarter ended March 31, 2013 that were not considered in the calculation of diluted earnings per share since the stock options' exercise price was greater than the average market price during these periods.

Note 7. Reclassification Adjustments Out of Other Comprehensive (Loss) Income

The following table summarizes the reclassification adjustments out of accumulated other comprehensive loss (in thousands):

Detail About Accumulated Other Comprehensive (Loss) Income Components	Amount reclassified from accumulated other comprehensive income (loss) Three months ended		Affected line item in the consolidated statement of comprehensive income
	March 31, 2014	March 31, 2013	
Available for sale securities:			
Gains on available for sale securities	$(7)	$(1,145)	Net securities gains
Tax benefit	3	454	Income tax expense
Net of tax	$(4)	$(691)	

Pension and other benefits:			
Amortization of net gains	$74	$882	Salaries and employee benefits
Amortization of prior service costs	(55)	(56)	Salaries and employee benefits
Tax benefit	8	323	Income tax expense
Net of tax	$11	$503	
Total reclassifications during the period, net of tax	$7	$(188)	

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Note 8. Fair Value Measurements and Fair Value of Financial Instruments

U.S. GAAP states that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Fair value measurements are not adjusted for transaction costs. A fair value hierarchy exists within U.S. GAAP that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 - Quoted prices for similar assets or liabilities in active markets, quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability;

Level 3 - Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The types of instruments valued based on quoted market prices in active markets include most U.S. government and agency securities, many other sovereign government obligations, liquid mortgage products, active listed equities and most money market securities. Such instruments are generally classified within level 1 or level 2 of the fair value hierarchy. The Company does not adjust the quoted price for such instruments.

The types of instruments valued based on quoted prices in markets that are not active, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency include most investment-grade and high-yield corporate bonds, less liquid mortgage products, less liquid agency securities, less liquid listed equities, state, municipal and provincial obligations, and certain physical commodities. Such instruments are generally classified within level 2 of the fair value hierarchy.

Level 3 is for positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate will be used. Management's best estimate consists of both internal and external support on certain Level 3 investments. Subsequent to inception, management only changes level 3 inputs and assumptions when corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalizations and other transactions across the capital structure, offerings in the equity or debt markets, and changes in financial ratios or cash flows.

For the three month period ending March 31, 2014, the Company has made no transfers of assets between Level 1 and Level 2, and has had no Level 3 activity.

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The following tables set forth the Company’s financial assets and liabilities measured on a recurring basis that were accounted for at fair value. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement (in thousands):

March 31, 2014:

Quoted Prices in	Significant	Significant