EMCLAIRE FINANCIAL CORP
Form 10-Q
May 13, 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

.. 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: **001-34527**

EMCLAIRE FINANCIAL CORP
(Exact name of registrant as specified in its charter)

Pennsylvania	25-1606091
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
612 Main Street, Emlenton, Pennsylvania	16373
(Address of principal executive offices)	(Zip Code)

(724) 867-2311
(Registrant's telephone number)

(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 ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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 as defined in Rule 12b-2 of the Exchange Act.

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

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

The number of shares outstanding of the Registrant's common stock was 1,770,158 at May 13, 2014.

EMCLAIRE FINANCIAL CORP

INDEX TO QUARTERLY REPORT ON FORM 10-Q

PART I - FINANCIAL INFORMATION

Item 1. Interim Financial Statements

Emclaire Financial Corp

Consolidated Balance Sheets

As of March 31, 2014 (Unaudited) and December 31, 2013

(Dollar amounts in thousands, except per share data)

	March 31, 2014	December 31, 2013
Assets		
Cash and due from banks	$ 2,127	$ 2,485
Interest earning deposits with banks	26,639	14,173
Cash and cash equivalents	28,766	16,658
Securities available for sale	122,196	117,304
Loans receivable, net of allowance for loan losses of $4,921 and $4,869	344,915	352,430
Federal bank stocks, at cost	2,752	3,977
Bank-owned life insurance	10,484	10,401
Accrued interest receivable	1,553	1,466
Premises and equipment, net	12,839	12,310
Goodwill	3,664	3,664
Core deposit intangible, net	908	965
Prepaid expenses and other assets	6,800	6,667
Total Assets	$ 534,877	$ 525,842
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Non-interest bearing	$ 111,318	$ 104,269
Interest bearing	355,844	327,737
Total deposits	467,162	432,006
Short-term borrowed funds	2,150	24,150
Long-term borrowed funds	15,000	20,000
Accrued interest payable	255	292

Accrued expenses and other liabilities	4,365	4,322
Total Liabilities	488,932	480,770
Commitments and Contingent Liabilities	-	-
Stockholders' Equity:		
Preferred stock, $1.00 par value, 3,000,000 shares authorized;		
Series B, non-cumulative preferred stock, $5,000 liquidation value, 5,000 shares issued and outstanding	5,000	5,000
Common stock, $1.25 par value, 12,000,000 shares authorized; 1,872,175 and 1,870,675 shares issued; 1,770,158 and 1,768,658 shares outstanding	2,340	2,338
Additional paid-in capital	19,544	19,478
Treasury stock, at cost; 102,017 shares	(2,114)	(2,114)
Retained earnings	24,077	23,650
Accumulated other comprehensive loss	(2,902)	(3,280)
Total Stockholders' Equity	45,945	45,072
Total Liabilities and Stockholders' Equity	$ 534,877	$ 525,842

See accompanying notes to consolidated financial statements.

1

Emclaire Financial Corp

Consolidated Statements of Net Income (Unaudited)

For the three months ended March 31, 2014 and 2013

(Dollar amounts in thousands, except per share data)

	For the three months ended March 31,	
	2014	2013
Interest and dividend income:		
Loans receivable, including fees	$ 4,030	$ 4,200
Securities:		
Taxable	404	417
Exempt from federal income tax	265	266
Federal bank stocks	35	17
Interest earning deposits with banks	11	14
Total interest and dividend income	4,745	4,914
Interest expense:		
Deposits	561	838
Borrowed funds	180	198
Total interest expense	741	1,036
Net interest income	4,004	3,878
Provision for loan losses	163	143
Net interest income after provision for loan losses	3,841	3,735
Noninterest income:		
Fees and service charges	378	398
Commissions on financial services	9	64
Title premiums	8	22
Net gain on sales of available for sale securities	658	85
Earnings on bank-owned life insurance	99	96
Other	287	266
Total noninterest income	1,439	931
Noninterest expense:		
Compensation and employee benefits	1,943	1,905
Premises and equipment	600	542
Intangible asset amortization	57	73
Professional fees	163	177

Federal deposit insurance	88	105
Other	1,371	773
Total noninterest expense	4,222	3,575
Income before provision for income taxes	1,058	1,091
Provision for income taxes	217	233
Net income	841	858
Preferred stock dividends	25	125
Net income available to common stockholders	$ 816	$ 733
Basic and diluted earnings per common share	$ 0.46	$ 0.42
Average common shares outstanding	1,769,389	1,760,927

See accompanying notes to consolidated financial statements.

2

Emclaire Financial Corp

Consolidated Statements of Comprehensive Income (Unaudited)

For the three months ended March 31, 2014 and 2013

(Dollar amounts in thousands)

	For the three months ended March 31,	
	2014	2013
Net income	$ 841	$ 858
Other comprehensive income (loss)		
Unrealized gains (losses) on securities:		
Unrealized holding gain (loss) arising during the period	1,231	(361)
Reclassification adjustment for gains included in net income	(658)	(85)
	573	(446)
Tax effect	(195)	152
Net of tax	378	(294)
Comprehensive income	$ 1,219	$ 564

See accompanying notes to consolidated financial statements.

3

Emclaire Financial Corp

Condensed Consolidated Statements of Cash Flows (Unaudited)

For the three months ended March 31, 2014 and 2013

(Dollar amounts in thousands)

	For the three months ended March 31, 2014			2013		
Cash flows from operating activities						
Net income	$	841		$	858	
Adjustments to reconcile net income to net cash provided by (used in) operating activities:						
Depreciation and amortization		184			171	
Provision for loan losses		163			143	
Amortization of premiums, net		65			36	
Amortization of intangible assets and mortgage servicing rights		57			73	
Realized gains on sales of available for sale securities, net		(658	)		(85	)
Net gains on foreclosed real estate		(2	)		(10	)
Restricted stock and stock option compensation		42			35	
Increase in bank-owned life insurance, net		(83	)		(82	)
Increase in accrued interest receivable		(87	)		(171	)
(Increase) decrease in prepaid expenses and		(354	)		84	

other assets				
Decrease in accrued interest payable	(37	)	(54	)
Increase in accrued expenses and other liabilities	43		103	
Net cash provided by operating activities	174		1,101	
Cash flows from investing activities				
Loan originations and principal collections, net	7,285		(5,697	)
Available for sale securities:				
Sales	21,559		1,775	
Maturities, repayments and calls	1,131		14,615	
Purchases	(26,350	)	(12,944	)
Redemption of federal bank stocks	1,225		68	
Proceeds from the sale of foreclosed real estate	29		59	
Write-down of foreclosed real estate	-		19	
Additions to premises and equipment	(713	)	(296	)
Net cash provided by (used in) investing activities	4,166		(2,401	)
Cash flows from financing activities				
Net increase in deposits	35,156		4,779	
Repayments on Federal Home Loan Bank advances	(5,000	)	-	
Net change in short-term borrowings	(22,000	)	-	
Proceeds from exercise of stock options, including tax benefit	26		20	
Dividends paid	(414	)	(478	)
Net cash provided by financing activities	7,768		4,321	
	12,108		3,021	

Increase in cash and cash equivalents				
Cash and cash equivalents at beginning of period		16,658		20,424
Cash and cash equivalents at end of period	$	28,766	$	23,445
Supplemental information:				
Interest paid	$	778	$	1,090
Supplemental noncash disclosure:				
Transfers from loans to foreclosed real estate		-		92

See accompanying notes to consolidated financial statements.

4

Emclaire Financial Corp

Consolidated Statements of Changes in Stockholders' Equity (Unaudited)

For the three months ended March 31, 2014 and 2013

(Dollar amounts in thousands, except per share data)

	For the three months ended March 31, 2014	2013
Balance at beginning of period	$ 45,072	$ 51,725
Net income	841	858
Other comprehensive income (loss)	378	(294)
Stock compensation expense	42	35
Dividends declared on preferred stock	(25)	(125)
Dividends declared on common stock	(389)	(353)
Exercise of stock options, including tax benefit	26	20
Balance at end of period	$ 45,945	$ 51,866
Common cash dividend per share	$ 0.22	$ 0.20

See accompanying notes to consolidated financial statements.

Emclaire Financial Corp

Notes to Consolidated Financial Statements (Unaudited)

1. Nature of Operations and Basis of Presentation

Emclaire Financial Corp (the Corporation) is a Pennsylvania corporation and the holding company of The Farmers National Bank of Emlenton (the Bank) and Emclaire Settlement Services, LLC (the Title Company). The Corporation provides a variety of financial services to individuals and businesses through its offices in Western Pennsylvania. Its primary deposit products are checking, savings and term certificate accounts and its primary lending products are residential and commercial mortgages, commercial business loans and consumer loans.

The consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiaries, the Bank and the Title Company. All significant intercompany transactions and balances have been eliminated in preparing the consolidated financial statements.

The accompanying unaudited consolidated financial statements for the interim periods include all adjustments, consisting of normal recurring accruals, which are necessary, in the opinion of management, to fairly reflect the Corporation’s consolidated financial position and results of operations. Additionally, these consolidated financial statements for the interim periods have been prepared in accordance with instructions for the Securities and Exchange Commission’s (SEC’s) Form 10-Q and Article 10 of Regulation S-X and therefore do not include all information or footnotes necessary for a complete presentation of financial condition, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America (GAAP). For further information, refer to the audited consolidated financial statements and footnotes thereto for the year ended December 31, 2013, as contained in the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2013 filed with the SEC.

The balance sheet at December 31, 2013 has been derived from the audited financial statements at that date but does not include all the information and footnotes required by GAAP for complete financial statements.

The preparation of financial statements, in conformity with GAAP, requires management to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, fair value of financial instruments, goodwill, real estate owned, the valuation of deferred tax assets and other-than-temporary impairment charges on securities. The results of operations for interim quarterly or year-to-date periods are not necessarily indicative of the results that may be expected for the entire year or any other period. Certain amounts previously reported may have been reclassified to conform to the current year’s financial statement presentation.

2. Participation in the Small Business Lending Fund (SBLF) of the U.S. Treasury Department (U.S. Treasury)

On August 18, 2011, the Corporation entered into a Securities Purchase Agreement (the Agreement) with the U.S. Treasury Department, pursuant to which the Corporation issued and sold to the U.S. Treasury 10,000 shares of Senior Non-Cumulative Perpetual Preferred Stock, Series B (Series B Preferred Stock), having a liquidation preference of $1,000 per share, for aggregate proceeds of $10.0 million, pursuant to the U.S. Treasury’s SBLF program. On September 17, 2013, with the approval of the Corporation’s primary federal banking regulator, the Corporation redeemed 5,000 shares, or 50%, of its Series B Preferred Stock held by the U.S. Treasury at an aggregate redemption price of $5.0 million, plus accrued but unpaid dividends. Following this redemption, the Treasury holds 5,000 shares of the Series B Preferred Stock, representing a remaining liquidation value of $5.0 million.

The Series B Preferred Stock is entitled to receive non-cumulative dividends payable quarterly on each January 1, April 1, July 1 and October 1, beginning October 1, 2011. The dividend rate, which is calculated on the aggregate liquidation amount, was initially set at 5% per annum based upon the current level of Qualified Small Business Lending (QSBL) by the Bank at that time. The dividend rate in the subsequent periods for the first two and one-half years through the quarter ending December 31, 2013 was based upon the percentage change in qualified lending between each dividend period and the baseline QSBL level established at the time the Agreement was entered into. Such dividend rate varied from 1% to 5% per annum. For the two year period beginning January 1, 2014, the dividend rate will be fixed at a rate of 2% per annum. If the Series B Preferred Stock remains outstanding for more than four-and-one-half years, beginning January 1, 2016, the dividend rate will be fixed at 9%. The dividend rate was 2.0% and 5.0%, respectively, for the quarters ended March 31, 2014 and 2013. Such dividends are not cumulative, but the Corporation may only declare and pay dividends on its common stock (or any other equity securities junior to the Series B Preferred Stock) if it has declared and paid dividends for the current dividend period on the Series B Preferred Stock, and will be subject to other restrictions on its ability to repurchase or redeem other securities.

Holders of the Series B Preferred Stock have the right to vote as a separate class on certain matters relating to the rights of holders of Series B Preferred Stock and on certain corporate transactions. Except with respect to such matters, the Series B Preferred Stock does not have voting rights.

The Corporation may redeem the shares of Series B Preferred Stock, in whole or in part, at any time at a redemption price equal to the sum of the liquidation amount and the per-share amount of any unpaid dividends for the then-current period, subject to any required prior approval by the Corporation’s primary federal banking regulator. If paid in part, payments are required to be at least 25% of the original issuance.

3. Earnings per Common Share

Basic earnings per common share (EPS) excludes dilution and is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted EPS includes the dilutive effect of additional potential common shares for assumed issuance of restricted stock and shares issued under stock options.

3. Earnings per Common Share (continued)

The factors used in the Corporation's earnings per common share computation follow:

(Dollar amounts in thousands, except for per share amounts)	For the three months ended March 31, 2014	2013
Earnings per common share - basic		
Net income	$ 841	$ 858
Less: Preferred stock dividends	25	125
Net income available to common stockholders	$ 816	$ 733
Average common shares outstanding	1,769,389	1,760,927
Basic earnings per common share	$ 0.46	$ 0.42
Earnings per common share - diluted		
Net income available to common stockholders	$ 816	$ 733
Average common shares outstanding	1,769,389	1,760,927
Add: Dilutive effects of assumed issuance of restricted stock and exercise of stock options	13,043	3,679
Average shares and dilutive potential common shares	1,782,432	1,764,606
Diluted earnings per common share	$ 0.46	$ 0.42
Stock options and restricted stock awards not considered in computing diluted earnings per share because they were antidilutive	67,000	68,061

4. Securities

The following table summarizes the Corporation's securities as of March 31, 2014 and December 31, 2013:

(Dollar amounts in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale:				
March 31, 2014:				
U.S. Treasury and federal agency	$ 3,469	$ -	$ (202)	$ 3,267
U.S. government sponsored entities and agencies	25,957	-	(539)	25,418

U.S. agency mortgage-backed securities: residential	18,371	-	(63)	18,308
U.S. agency collateralized mortgage obligations: residential	39,938	9	(1,629)	38,318
State and political subdivisions	34,365	720	(623)	34,462
Corporate debt securities	-	-	-	-
Equity securities	2,356	105	(38)	2,423
	$ 124,456	$ 834	$ (3,094)	$ 122,196
December 31, 2013:				
U.S. Treasury and federal agency	$ 4,466	$ -	$ (298)	$ 4,168
U.S. government sponsored entities and agencies	23,637	-	(745)	22,892
U.S. agency mortgage-backed securities: residential	11,020	341	-	11,361
U.S. agency collateralized mortgage obligations: residential	41,751	2	(2,031)	39,722
State and political subdivisions	36,657	830	(988)	36,499
Corporate debt securities	250	-	(9)	241
Equity securities	2,356	131	(66)	2,421
	$ 120,137	$ 1,304	$ (4,137)	$ 117,304

8

4. Securities (continued)

The following table summarizes scheduled maturities of the Corporation's debt securities as of March 31, 2014. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities and collateralized mortgage obligations are not due at a single maturity and are shown separately.

(Dollar amounts in thousands)	Available for sale	
	Amortized Cost	Fair Value
Due in one year or less	$ 1,000	$ 1,004
Due after one year through five years	23,816	23,755
Due after five through ten years	35,344	34,908
Due after ten years	3,631	3,480
Mortgage-backed securities: residential	18,371	18,308
Collateralized mortgage obligations: residential	39,938	38,318
	$ 122,100	$ 119,773

Information pertaining to securities with gross unrealized losses at March 31, 2014 and December 31, 2013, aggregated by investment category and length of time that individual securities have been in a continuous loss position are included in the table below:

(Dollar amounts in thousands)	Less than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
March 31, 2014:						
U.S. Treasury and federal agency	$ 2,840	$ (146)	$ 427	$ (56)	$ 3,267	$ (202)
U.S. government sponsored entities and agencies	24,437	(520)	981	(19)	25,418	(539)
U.S. agency mortgage-backed securities: residential	18,308	(63)	-	-	18,308	(63)
U.S. agency collateralized mortgage obligations: residential	26,832	(1,108)	9,651	(521)	36,483	(1,629)
State and political subdivisions	13,239	(616)	150	(7)	13,389	(623)
Equity securities	481	(26)	939	(12)	1,420	(38)
	$ 86,137	$ (2,479)	$ 12,148	$ (615)	$ 98,285	$ (3,094)
December 31, 2013:						
U.S. Treasury and federal agency	$ 4,168	$ (298)	$ -	$ -	$ 4,168	$ (298)
U.S. government sponsored entities and agencies	22,891	(745)	-	-	22,891	(745)
	33,805	(1,729)	4,982	(302)	38,787	(2,031)

U.S. agency mortgage-backed securities: residential						
State and political subdivisions	13,262	(988)	-	-	13,262	(988)
Corporate debt securities	242	(9)	-	-	242	(9)
Equity securities	1,142	(66)	-	-	1,142	(66)
	$ 75,510	$ (3,835)	$ 4,982	$ (302)	$ 80,492	$ (4,137)

Gains on sales of available for sale securities for the three months ended March 31 were as follows:

(Dollar amounts in thousands)	For the three months ended March 31,	
	2014	2013
Proceeds	$ 21,559	$ 1,775
Gains	658	85
Tax provision related to gains	224	29

9

4. Securities (continued)

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic, market or other conditions warrant such evaluation. Consideration is given to: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions and (4) whether the Corporation has the intent to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis. If the Corporation intends to sell an impaired security, or if it is more likely than not the Corporation will be required to sell the security before its anticipated recovery, the Corporation records an other-than-temporary loss in an amount equal to the entire difference between fair value and amortized cost. Otherwise, only the credit portion of the estimated loss on debt securities is recognized in earnings, with the other portion of the loss recognized in other comprehensive income. For equity securities determined to be other-than-temporarily impaired, the entire amount of impairment is recognized through earnings.

There were four equity securities in an unrealized loss position as of March 31, 2014, none of which were in an unrealized loss position for more than 12 months. Equity securities owned by the Corporation consist of common stock of various financial service providers. The investment securities are in an unrealized loss position as a result of recent market volatility. The Corporation does not invest in these securities with the intent to sell them for a profit in the near term. For investments in equity securities, in addition to the general factors mentioned above for determining whether the decline in market value is other-than-temporary, the analysis of whether an equity security is other-than-temporarily impaired includes a review of the profitability, capital adequacy and other relevant information available to determine the financial position and near term prospects of each issuer. The results of analyzing the aforementioned metrics and financial fundamentals suggest recovery of amortized cost as the sector improves. Based on that evaluation, and given that the Corporation's current intention is not to sell any impaired security and it is more likely than not it will not be required to sell these securities before the recovery of their amortized cost basis, the Corporation does not consider the equity securities with unrealized losses as of March 31, 2014 to be other-than-temporarily impaired.

There were 113 debt securities in an unrealized loss position as of March 31, 2014, of which 11 were in an unrealized loss position for more than 12 months. Of these 113 securities, 6 were U.S. Treasury securities, 7 were U.S. agency mortgage-backed securities, 20 were U.S. government sponsored entity and agency securities, 25 were government-backed collateralized mortgage obligations and 55 were state and political subdivision securities. The unrealized losses associated with these securities were not due to the deterioration in the credit quality of the issuer that would likely result in the non-collection of contractual principal and interest, but rather have been caused by a rise in interest rates from the time the securities were purchased. Based on that evaluation and other general considerations, and given that the Corporation's current intention is not to sell any impaired securities and it is more likely than not it will not be required to sell these securities before the recovery of its amortized cost basis, the Corporation does not consider the debt securities with unrealized losses as of March 31, 2014 to be other-than-temporarily impaired.

5. Loans Receivable and Related Allowance for Loan Losses

The Corporation's loans receivable as of the respective dates are summarized as follows:

(Dollar amounts in thousands)	March 31, 2014	December 31, 2013
Mortgage loans on real estate:		
Residential first mortgages	$ 105,836	$ 105,541
Home equity loans and lines of credit	86,761	87,928
Commercial real estate	95,301	101,499
	287,898	294,968
Other loans:		
Commercial business	52,540	53,214
Consumer	9,398	9,117
	61,938	62,331
Total loans, gross	349,836	357,299
Less allowance for loan losses	4,921	4,869
Total loans, net	$ 344,915	$ 352,430

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of March 31, 2014:

(Dollar amounts in thousands)	Impaired Loans with Specific Allowance					
	As of March 31, 2014			For the three months ended March 31, 2014		
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages	$ 81	$ 81	$ 21	$ 82	$ 1	$ 1
Home equity and lines of credit	-	-	-	-	-	-
Commercial real estate	3,664	2,723	209	2,621	7	2
Commercial business	417	417	235	209	5	-
Consumer	-	-	-	-	-	-
Total	$ 4,162	$ 3,221	$ 465	$ 2,912	$ 13	$ 3

	Impaired Loans with No Specific Allowance		
	As of March 31, 2014	For the three months ended March 31, 2014	
			Cash Basis

	Unpaid Principal Balance	Recorded Investment	Average Recorded Investment	Interest Income Recognized in Period	Interest Recognized in Period
Residential first mortgages	$ -	$ -	$ 10	$ -	$ -
Home equity and lines of credit	-	-	-	-	-
Commercial real estate	1,103	704	690	2	2
Commercial business	388	386	361	-	-
Consumer	1,348	1,348	1,348	-	-
Total	$ 2,839	$ 2,438	$ 2,409	$ 2	$ 2

5. Loans Receivable and Related Allowance for Loan Losses (continued)

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of December 31, 2013:

(Dollar amounts in thousands)

	Impaired Loans with Specific Allowance					
	As of December 31, 2013			For the year ended December 31, 2013		
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages	$ 82	$ 82	$ 21	$ 49	$ 5	$ 4
Home equity and lines of credit	-	-	-	-	-	-
Commercial real estate	3,462	2,521	181	3,202	13	13
Commercial business	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Total	$ 3,544	$ 2,603	$ 202	$ 3,251	$ 18	$ 17

	Impaired Loans with No Specific Allowance				
	As of December 31, 2013		For the year ended December 31, 2013		
	Unpaid Principal Balance	Recorded Investment	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages	$ 20	$ 20	$ 4	$ 1	$ -
Home equity and lines of credit	-	-	-	-	-
Commercial real estate	1,074	675	584	5	5
Commercial business	336	336	354	-	-
Consumer	1,348	1,348	1,457	-	-
Total	$ 2,778	$ 2,379	$ 2,399	$ 6	$ 5

During the quarter ended March 31, 2013, the average recorded investment of impaired loans with a specific allowance was $4.0 million and the Corporation recognized interest income of $4,000 on these loans and the average recorded investment of impaired loans with no specific allowance was $2.5 million and interest income of $1,000 was recognized on these loans.

Unpaid principal balance includes any loans that have been partially charged off but not forgiven. Accrued interest is not included in the recorded investment in loans based on the amounts not being material.

Troubled debt restructurings (TDR). The Corporation has certain loans that have been modified in order to maximize collection of loan balances. If, for economic or legal reasons related to the customer's financial difficulties, management grants a concession compared to the original terms and conditions of the loan that it would not have otherwise considered, the modified loan is classified as a TDR. Concessions related to TDRs generally do not include forgiveness of principal balances. The Corporation generally does not extend additional credit to borrowers with loans classified as TDRs.

At March 31, 2014 and December 31, 2013, the Corporation had $2.5 million of loans classified as TDRs, which are included in impaired loans above. At March 31, 2014 and December 31, 2013, the Corporation had $56,000 of the allowance for loan losses allocated to these specific loans. At March 31, 2013, the Corporation had $2.3 million of loans classified as TDRs with $35,000 of the allowance for loan losses allocated to these specific loans.

5. Loans Receivable and Related Allowance for Loan Losses (continued)

During the three month period ended March 31, 2014, the Corporation did not modify any additional loans as TDRs. During the three month period ended March 31, 2013, the Corporation modified a residential mortgage loan with a pre- and post-modification recorded investment of $83,000 as a TDR due to financial difficulties experienced by the borrower. The modification included a reduction in the interest rate from 6.75% to 4.00% and a 65 month extension of the original term.

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms. During the three month period ended March 31, 2014, there were defaults on three loans classified as TDRs which totaled $430,000. During the three month period ended March 31 2013, the Corporation did not have any loans which were modified as TDRs for which there was a payment default within twelve months following the modification.

Credit Quality Indicators. Management categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors.

Commercial real estate and commercial business loans not identified as impaired are evaluated as risk rated pools of loans utilizing a risk rating practice that is supported by a quarterly special asset review. In this review process, strengths and weaknesses are identified, evaluated and documented for each criticized and classified loan and borrower, strategic action plans are developed, risk ratings are confirmed and the loan’s performance status is reviewed.

Management has determined certain portions of the loan portfolio to be homogeneous in nature and assigns like reserve factors for the following loan pool types: residential real estate, home equity loans and lines of credit, and consumer installment and personal lines of credit.

The reserve allocation for risk rated loan pools is developed by applying the following factors:

Historic: Management utilizes a computer model to develop the historical net charge-off experience which is used to formulate the assumptions employed in the migration analysis applied to estimate future losses in the portfolio. Outstanding balance and charge-off information are input into the model and historical loss migration rate assumptions are developed to apply to pass, special mention, substandard and doubtful risk rated loans. A twelve-quarter rolling weighted-average is utilized to anticipate probable incurred losses in the portfolios.

Qualitative: Qualitative adjustment factors for pass, special mention, substandard and doubtful ratings are developed and applied to risk rated loans to allow for: quality of lending policies and procedures; national and local economic and business conditions; changes in the nature and volume of the portfolio; experiences, ability and depth of lending management; changes in trends, volume and severity of past due, nonaccrual and classified loans and loss and recovery trends; quality of loan review systems; concentrations of credit and other external factors.

Management uses the following definitions for risk ratings:

Pass: Loans classified as pass typically exhibit good payment performance and have underlying borrowers with acceptable financial trends where repayment capacity is evident. These borrowers typically would have a sufficient cash flow that would allow them to weather an economic downturn and the value of any underlying collateral could withstand a moderate degree of depreciation due to economic conditions.

Special Mention: Loans classified as special mention are characterized by potential weaknesses that could jeopardize repayment as contractually agreed. These loans may exhibit adverse trends such as increasing leverage, shrinking profit margins and/or deteriorating cash flows. These borrowers would inherently be more vulnerable to the application of economic pressures.

13

5. Loans Receivable and Related Allowance for Loan Losses (continued)

Substandard: Loans classified as substandard exhibit weaknesses that are well-defined to the point that repayment is jeopardized. Typically, the Corporation is no longer adequately protected by both the apparent net worth and repayment capacity of the borrower.

Doubtful: Loans classified as doubtful have advanced to the point that collection or liquidation in full, on the basis of currently ascertainable facts, conditions and value, is highly questionable or improbable.

The following table presents the classes of the loan portfolio summarized by the aggregate pass and the criticized categories of special mention, substandard and doubtful within the Corporation's internal risk rating system as of March 31, 2014 and December 31, 2013:

(Dollar amounts in thousands)

	Not Rated	Pass	Special Mention	Substandard	Doubtful	Total
March 31, 2014:						
Residential first mortgages	$ 105,263	$ -	$ -	$ 573	$ -	$ 105,836
Home equity and lines of credit	86,565	-	-	196	-	86,761
Commercial real estate	-	87,933	247	7,121	-	95,301
Commercial business	-	48,142	1,688	2,710	-	52,540
Consumer	8,050	-	-	1,348	-	9,398
Total	$ 199,878	$ 136,075	$ 1,935	$ 11,948	$ -	$ 349,836
December 31, 2013:						
Residential first mortgages	$ 104,983	$ -	$ -	$ 558	$ -	$ 105,541
Home equity and lines of credit	87,868	-	-	60	-	87,928
Commercial real estate	-	93,973	256	7,270	-	101,499
Commercial business	-	50,008	674	2,532	-	53,214
Consumer	7,769	-	-	1,348	-	9,117
Total	$ 200,620	$ 143,981	$ 930	$ 11,768	$ -	$ 357,299

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and nonperforming loans as of March 31, 2014 and December 31, 2013:

(Dollar amounts in thousands)

	Performing			Nonperforming		
	Accruing Loans Not Past Due	Accruing 30-59 Days Past Due	Accruing 60-89 Days Past Due	Accruing 90 Days + Past Due	Nonaccrual	Total Loans
March 31, 2014:						
Residential first mortgages	$104,013	$ 1,250	$ -	$ -	$ 573	$105,836
Home equity and lines of credit	86,168	278	119	-	196	86,761
Commercial real estate	91,806	50	367	-	3,078	95,301
Commercial business	51,519	217	-	-	804	52,540
Consumer	7,946	93	11	-	1,348	9,398
Total loans	$341,452	$ 1,888	$ 497	$ -	$ 5,999	$349,836
December 31, 2013:						
Residential first mortgages	$103,821	$ 884	$ 278	$ 38	$ 520	$105,541
Home equity and lines of credit	87,302	394	172	-	60	87,928
Commercial real estate	98,095	516	22	-	2,866	101,499
Commercial business	52,581	258	-	24	351	53,214
Consumer	7,682	61	26	-	1,348	9,117
Total loans	$349,481	$ 2,113	$ 498	$ 62	$ 5,145	$357,299

5. Loans Receivable and Related Allowance for Loan Losses (continued)

The following table presents the Corporation's nonaccrual loans by aging category as of March 31, 2014 and December 31, 2013:

(Dollar amounts in thousands)

	Not Past Due	30-59 Days Past Due	60-89 Days Past Due	90 Days + Past Due	Total Loans
March 31, 2014:					
Residential first mortgages	$ 87	$ 81	$ -	$ 405	$ 573
Home equity and lines of credit	-	-	-	196	196
Commercial real estate	718	2,067	-	293	3,078
Commercial business	479	-	-	325	804
Consumer	1,348	-	-	-	1,348
Total loans	$ 2,632	$ 2,148	$ -	$ 1,219	$ 5,999
December 31, 2013:					
Residential first mortgages	$ 88	$ -	$ 82	$ 350	$ 520
Home equity and lines of credit	-	-	-	60	60
Commercial real estate	412	2,148	-	306	2,866
Commercial business	65	-	-	286	351
Consumer	1,348	-	-	-	1,348
Total loans	$ 1,913	$ 2,148	$ 82	$ 1,002	$ 5,145

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

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL.

5. Loans Receivable and Related Allowance for Loan Losses (continued)

The following table details activity in the ALL and the recorded investment by portfolio segment based on impairment method:

(Dollar amounts in thousands)

	Residential Mortgages	Home Equity & Lines of Credit	Commercial Real Estate	Commercial Business	Consumer	Total
Three months ended March 31, 2014:						
Allowance for loan losses:						
Beginning Balance	$ 923	$ 625	$ 2,450	$ 822	$ 49	$ 4,869
Charge-offs	(78)	-	(2)	(17)	(35)	(132)
Recoveries	-	-	5	7	9	21
Provision	91	(6)	(232)	282	28	163
Ending Balance	$ 936	$ 619	$ 2,221	$ 1,094	$ 51	$ 4,921
Three months ended March 31, 2013:						
Allowance for loan losses:						
Beginning Balance	$ 828	$ 730	$ 3,090	$ 636	$ 66	$ 5,350
Charge-offs	(5)	-	-	-	(32)	(37)
Recoveries	1	-	2	-	29	32
Provision	(17)	(3)	97	66	-	143
Ending Balance	$ 807	$ 727	$ 3,189	$ 702	$ 63	$ 5,488
At March 31, 2013:						
Ending ALL balance attributable to loans:						
Individually evaluated for impairment	21	-	209	235	-	465
Collectively evaluated for impairment	915	619	2,012	859	51	4,456
Total loans:						
Individually evaluated for impairment	81	-	3,427	803	1,348	5,659
Collectively evaluated for impairment	105,755	86,761	91,874	51,737	8,050	344,177
At December 31, 2013:						
Ending ALL balance attributable to loans:						
Individually evaluated for impairment	21	-	181	-	-	202
Collectively evaluated for impairment	902	625	2,269	822	49	4,667
Total loans:						
Individually evaluated for impairment	102	-	3,196	336	1,348	4,982
Collectively evaluated for impairment	105,439	87,928	98,303	52,878	7,769	352,317

The allowance for loan losses is based on estimates and actual losses may vary from current estimates. Management believes that the granularity of the homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date.

6. Goodwill and Intangible Assets

The following table summarizes the Corporation's acquired goodwill and intangible assets as of March 31, 2014 and December 31, 2013:

(Dollar amounts in thousands)	March 31, 2014		December 31, 2013	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Goodwill	$3,664	$ -	$ 3,664	$ -
Core deposit intangibles	4,027	3,119	4,027	3,062
Total	$7,691	$ 3,119	$ 7,691	$ 3,062

Goodwill resulted from three previous branch acquisitions. Goodwill represents the excess of the total purchase price paid for the branch acquisitions over the fair value of the assets acquired, net of the fair value of the liabilities assumed. Goodwill is not amortized but is evaluated for impairment on an annual basis or whenever events or changes in circumstances indicate the carrying value may not be recoverable. Impairment exists when a reporting unit's carrying value of goodwill exceeds its fair value. The Corporation has selected November 30 as the date to perform the annual impairment test. No goodwill impairment charges were recorded during 2013 or in the first three months of 2014. The core deposit intangible asset is amortized using the double declining balance method over a weighted average estimated life of nine years and is not estimated to have a significant residual value. During the three month period ending March 31, 2014, the Corporation recorded intangible amortization expense totaling $57,000, compared to $73,000 for the same periods in the prior year.

7. Stock Compensation Plans

In April 2014, the Corporation adopted the 2014 Stock Incentive Plan (the Plan), which is shareholder approved and permits the grant of restricted stock awards and options to its directors, officers and employees for up to 176,866 shares of common stock.

In addition, the Corporation's 2007 Stock Incentive Plan and Trust (the Plan), which is shareholder approved, permits the grant of restricted stock awards and options to its directors, officers and employees for up to 177,496 shares of common stock.

Incentive stock options, non-incentive or compensatory stock options and share awards may be granted under the Plans. The exercise price of each option shall at least equal the market price of a share of common stock on the date of grant and have a contractual term of ten years. Options shall vest and become exercisable at the rate, to the extent and subject to such limitations as may be specified by the Corporation. Compensation cost related to share-based payment transactions must be recognized in the financial statements with measurement based upon the fair value of the equity instruments issued.

A summary of option activity under the Plans as of March 31, 2014, and changes during the period then ended is presented below:

	Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value (in thousands)	Weighted-Average Remaining Term (in years)
Outstanding as of January 1, 2014	79,250	$ 24.97	$ -	3.8
Granted	-	-	-	-
Exercised	(1,500)	17.00	-	-
Forfeited	-	-	-	-
Outstanding as of March 31, 2014	77,750	$ 25.12	$ 63,635	3.5
Exercisable as of March 31, 2014	77,250	$ 25.19	$ 58,355	3.5

7. Stock Compensation Plans (continued)

A summary of the status of the Corporation's nonvested option shares as of March 31, 2014, and changes during the period then ended is presented below:

	Options	Weighted-Average Grant-date Fair Value
Nonvested at January 1, 2014	500	$ 1.44
Granted	-	-
Vested	-	-
Forfeited	-	-
Nonvested as of March 31, 2014	500	$ 1.44

A summary of the status of the Corporation's nonvested restricted stock awards as of March 31, 2014, and changes during the period then ended is presented below:

	Shares	Weighted-Average Grant-date Fair Value
Nonvested at January 1, 2014	25,800	$ 20.11
Granted	-	-
Vested	-	-
Forfeited	-	-
Nonvested as of March 31, 2014	25,800	$ 20.11

For the three month period ended March 31, 2014, the Corporation recognized $42,000 in stock compensation expense, compared to $35,000 for the same periods in 2013. As of March 31, 2014, there was $311,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plans. That cost is expected to be recognized over a weighted-average period of 1.6 years. It is the Corporation's policy to issue shares on the vesting date for restricted stock awards. Unvested restricted stock awards do not receive dividends declared by the Corporation.

8. Employee Benefit Plans

The Corporation provides pension benefits for eligible employees through a defined benefit pension plan. Substantially all employees participate in the retirement plan on a non-contributory basis, and are fully vested after three years of service. Effective January 1, 2009, the plan was closed to new participants.

The Corporation provided the requisite notice to plan participants on March 12, 2013 of the determination to freeze the plan (curtailment). While the freeze was not effective until April 30, 2013, management determined that participants would not satisfy, within the provisions of the plan, 2013 eligibility requirements based on minimum hours worked for 2013. Therefore, employees ceased to earn benefits as of January 1, 2013. This amendment to the plan will not affect benefits earned by the participants prior to the date of the freeze. The expense associated with the plan was immaterial for the quarters ended March 31, 2014 and 2013.

9. Fair Value

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair value.

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the Corporation has the ability to access at 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.

9. Fair Value (continued)

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

An asset or liability's level is based on the lowest level of input that is significant to the fair value measurement.

The Corporation used the following methods and significant assumptions to estimate fair value:

Cash and cash equivalents – The carrying value of cash, due from banks and interest bearing deposits approximates fair value and are classified as Level 1.

Securities available for sale – The fair value of all investment securities are based upon the assumptions market participants would use in pricing the security. If available, investment securities are determined by quoted market prices (Level 1). Level 1 includes U.S. Treasury, federal agency securities and certain equity securities. For investment securities where quoted market prices are not available, fair values are calculated based on market prices on similar securities (Level 2). Level 2 includes U.S. Government sponsored entities and agencies, mortgage-backed securities, collateralized mortgage obligations, state and political subdivision securities and corporate debt securities. For investment securities where quoted prices or market prices of similar securities are not available, fair values are calculated by using unobservable inputs (Level 3) and may include certain equity securities held by the Corporation. The Level 3 equity security valuations were supported by an analysis prepared by the Corporation which relies on inputs such as the security issuer's publicly attainable financial information, multiples derived from prices in observed transactions involving comparable businesses and other market, financial and nonfinancial factors.

Loans – The fair value of loans receivable was estimated based on the discounted value of the future cash flows using the current rates being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification.

Impaired loans – At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive a specific allowance for loan losses. For collateral dependent loans, fair value is commonly based on real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management’s historical knowledge, changes in market conditions from the time of the valuation, and management’s expertise and knowledge of the client and client’s business, resulting in a Level 3 classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly. As of March 31, 2014, the fair value of impaired loans consists of loan balances of $3.2 million, net of a valuation allowance of $465,000, compared to loan balances of $2.5 million, net of a valuation allowance of $181,000, at December 31, 2013. There was $272,000 of additional provision for loan losses recorded for impaired loans during the three month period ended March 31, 2014. There was $5,000 of additional provision recorded for impaired loans for the same period in 2013.

9. Fair Value (continued)

Other Real estate owned (OREO) – Assets acquired through or instead of foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals. Management's ongoing review of appraisal information may result in additional discounts or adjustments to the valuation based upon more recent market sales activity or more current appraisal information derived from properties of similar type and/or locale. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. As of March 31, 2014 and December 31, 2013, OREO measured at fair value less costs to sell had a net carrying amount of $80,000, which was made up of the outstanding balance of $104,000 and write-downs of $24,000. There was no expense recorded during the quarters ended March 31, 2014 and 2013 associated with the write-down of OREO.

Appraisals for both collateral-dependent impaired loans and OREO are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed by the Corporation. Once received, management reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On an annual basis, the Corporation compares the actual selling price of OREO that has been sold to the most recent appraisal to determine what additional adjustment should be made to the appraisal value to arrive at fair value. The most recent analysis performed indicated that a discount of 10% should be applied.

Federal bank stock – It is not practical to determine the fair value of federal bank stocks due to restrictions placed on its transferability.

Deposits – The fair value of deposits with no stated maturity, such as non-interest bearing demand deposits, checking with interest, savings and money market accounts, is equal to the amount payable on demand resulting in either a Level 1 or Level 2 classification. The fair values of time deposits are based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar maturities resulting in a Level 2 classification.

Borrowings – The fair value of borrowings with the FHLB is estimated using discounted cash flows based on current incremental borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

Accrued interest receivable and payable – The carrying value of accrued interest receivable and payable approximates fair value. The fair value classification is consistent with the related financial instrument.

9. Fair Value (continued)

For assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy are as follows:

(Dollar amounts in thousands) Description	Total	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
March 31, 2014:				
U.S. Treasury and federal agency	$3,267	$ 3,267	$ -	$ -
U.S. government sponsored entities and agencies	25,418	-	25,418	-
Mortgage-backed securities: residential	18,308	-	18,308	-
Collateralized mortgage obligations: residential	38,318	-	38,318	-
State and political subdivision	34,462	-	34,462	-
Equity securities	2,423	1,770	-	653
	$122,196	$ 5,037	$ 116,506	$ 653
December 31, 2013:				
U.S. Treasury and federal agency	$4,168	$ 4,168	$ -	$ -
U.S. government sponsored entities and agencies	22,892	-	22,892	-
U.S. agency mortgage-backed securities: residential	11,361	-	11,361	-
U.S. agency collateralized mortgage obligations: residential	39,722	-	39,722	-
State and political subdivisions	36,499	-	36,499	-
Corporate debt securities	241	241	-	-
Equity securities	2,421	1,768	-	653
	$117,304	$ 6,177	$ 110,474	$ 653

The Corporation's policy is to transfer assets or liabilities from one level to another when the methodology to obtain the fair value changes such that there are more or fewer unobservable inputs as of the end of the reporting period. During the three month period ended March 31, 2014, the Corporation had no transfers between levels. The following table presents changes in Level 3 assets measured on a recurring basis for the three month periods ended March 31, 2014 and 2013:

(Dollar amounts in thousands)	Three months ended March 31, 2014	2013
Balance at the beginning of the period	$ 653	$ 653
Total gains or losses (realized/unrealized):	-	-
Included in earnings	-	-

Included in other comprehensive income	-	-
Issuances	-	-
Transfers in and/or out of Level 3	-	-
Balance at the end of the period	$ 653	$ 653

9. Fair Value (continued)

For assets measured at fair value on a non-recurring basis, the fair value measurements by level within the fair value hierarchy are as follows:

(Dollar amounts in thousands) Description	Total	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
March 31, 2014:				
Impaired commercial real estate loans	$2,514	$ -	$ -	$ 2,514
Impaired commercial business loans	182	-	-	182
Other residential real estate owned	80	-	-	80
	$2,776	$ -	$ -	$ 2,776
December 31, 2013:				
Impaired commercial real estate loans	$2,340	$ -	$ -	$ 2,340
Other residential real estate owned	80	-	-	80
	$2,420	$ -	$ -	$ 2,420

The following table presents quantitative information about Level 3 fair value measurements for assets measured at fair value on a non-recurring basis:

(Dollar amounts in thousands)		Valuation Techniques(s)	Unobservable Input (s)	Range
March 31, 2014:				
Impaired commercial real estate loans	$2,514	Sales comparison approach/ Contractual provision of USDA loan	Adjustment for differences between comparable sales	0% - 10%
Impaired commercial business loans	182	Liquidation value of business assets	N/A	76%
Other residential real estate owned	80	Sales comparison approach	Adjustment for differences between comparable sales	10%
December 31, 2013:				
Impaired commercial real estate loans	2,340	Sales comparison approach/ Contractual provision of USDA loan	Adjustment for differences between comparable sales	0% - 10%
Other residential real estate owned	80	Sales comparison approach		10%

Adjustment for differences between comparable sales

The two tables above exclude a $60,000 impaired residential mortgage loan classified as a troubled debt restructure which was measured at fair value using a discounted cash flow methodology at March 31, 2014.

Included in impaired commercial real estate loans is a loan guaranteed by the United States Department of Agriculture (USDA) with balances of $349,000 and $350,000, respectively, as of March 31, 2014 and December 31, 2013. The guarantee covers 90% of the principal balance outstanding. In determining the fair value of this loan, the Corporation considered the contractual provisions of the loan and did not rely on the fair value of the underlying collateral. As such, the Corporation applied a 10% discount to the loan which represents the portion of the loan at risk. The weighted average discount on impaired loans as of March 31, 2014 and December 31, 2013 was 14.4% and 1.5%, respectively.

9. Fair Value (continued)

The following table sets forth the carrying amount and estimated fair values of the Corporation's financial instruments included in the consolidated balance sheet as of March 31, 2014 and December 31, 2013:

(Dollar amounts in thousands)

	Carrying	Fair Value Measurements using:			
Description	Amount	Total	Level 1	Level 2	Level 3
March 31, 2014:					
Financial Assets:					
Cash and cash equivalents	$28,766	$28,766	$28,766	$-	$-
Securities available for sale	122,196	122,196	5,037	116,506	653
Loans, net	344,915	348,670	-	-	348,670
Federal bank stock	2,752	N/A	N/A	N/A	N/A
Accrued interest receivable	1,553	1,553	42	448	1,063
	500,182	501,184	33,845	116,954	350,386
Financial Liabilities:					
Deposits	467,162	469,602	347,063	122,539	-
Borrowed funds	17,150	17,913	-	17,913	-
Accrued interest payable	255	255	5	250	-
	484,567	487,770	347,068	140,702	-

	Carrying	Fair Value Measurements using:			
	Amount	Total	Level 1	Level 2	Level 3
December 31, 2013:					
Financial Assets:					
Cash and cash equivalents	$16,658	$16,658	$16,658	$-	$-
Securities available for sale	117,304	117,304	5,936	110,715	653
Loans, net	352,430	356,123	-	-	356,123
Federal bank stock	3,977	N/A	N/A	N/A	N/A
Accrued interest receivable	1,466	1,466	34	430	1,002
	491,835	491,551	22,628	111,145	357,778
Financial Liabilities:					
Deposits	432,006	434,552	325,983	108,569	-
FHLB advances	44,150	45,241	-	45,241	-
Accrued interest payable	292	292	5	287	-
	476,448	480,085	325,988	154,097	-

10. Accumulated Other Comprehensive Income (Loss)

The following tables summarize the changes within each classification of accumulated other comprehensive income (loss), net of tax, for the three months ended March 31, 2014 and 2013 and summarizes the significant amounts reclassified out of each component of accumulated other comprehensive income:

(Dollar amounts in thousands)	Unrealized Gains and Losses on Available-for-Sale Securities	Defined Benefit Pension Items	Totals
Accumulated Other Comprehensive Loss at January 1, 2014	$ (1,870)	$(1,410)	$(3,280)
Other comprehensive income before reclassification	812	-	812
Amounts reclassified from accumulated other comprehensive income	(434)	-	(434)
Net current period other comprehensive income	378	-	378
Accumulated Other Comprehensive Loss at March 31, 2014	$ (1,492)	$(1,410)	$(2,902)

(Dollar amounts in thousands) Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income For the three months ended March 31, 2014	Affected Line Item in the Statement Where Net Income is Presented
Unrealized gains and losses on available-for-sale securities	$ 658	Gain on sale of securities
	(224)	Tax expense
Total reclassifications for the period	$ 434	Net of tax

(Dollar amounts in thousands)	Unrealized Gains and Losses on Available-for-Sale Securities	Defined Benefit Pension Items	Totals
Accumulated Other Comprehensive Income at January 1, 2013	$ 2,365	$(1,795)	$570
Other comprehensive income before reclassification	(238)	-	(238)
Amounts reclassified from accumulated other comprehensive income	(56)	-	(56)
Net current period other comprehensive loss	(294)	-	(294)
Accumulated Other Comprehensive Income at March 31, 2013	$ 2,071	$(1,795)	$276

(Dollar amounts in thousands) Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income For the three months ended March 31, 2013			Affected Line Item in the Statement Where Net Income is Presented
Unrealized gains and losses on available-for-sale securities	$	85		Gain on sale of securities
		(29	)	Tax expense
Total reclassifications for the period	$	56		Net of tax

24

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This section discusses the consolidated financial condition and results of operations of Emclaire Financial Corp and its wholly owned subsidiaries, the Bank and the Title Company, for the three months ended March 31, 2014, compared to the same period in 2013 and should be read in conjunction with the Corporation's Annual Report on Form 10-K for the year ended December 31, 2013, filed with the SEC and with the accompanying consolidated financial statements and notes presented on pages 1 through 24 of this Form 10-Q.

This Form 10-Q, including the financial statements and related notes, contains forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These forward looking statements represent plans, estimates, objectives, goals, guidelines, expectations, intentions, projections and statements of our beliefs concerning future events, business plans, objectives, expected operating results and the assumptions upon which those statements are based. Forward looking statements include without limitation, any statement that may predict, forecast, indicate or imply future results, performance or achievements, and are typically identified with words such as "may," "could," "should," "will," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan" or words or phrases of simil We caution that the forward looking statements are based largely on our expectations and are subject to a number of known and unknown risks and uncertainties that are subject to change based on factors which are, in many instances, beyond our control. Actual results, performances or achievements could differ materially from those contemplated, expressed or implied by the forward looking statements. Therefore, we caution you not to place undue reliance on our forward looking information and statements. Except as required by applicable law or regulation, we will not update the forward looking statements to reflect actual results or changes in factors affecting the forward looking statements.

CHANGES IN FINANCIAL CONDITION

Total assets increased $9.0 million, or 1.7%, to $534.9 million at March 31, 2014 from $525.8 million at December 31, 2013. This increase resulted primarily from increases in cash and equivalents and securities of $12.1 million and $4.9 million, respectively, which was funded by a $35.2 million increase in customer deposits. This deposit increase, along with a $7.5 million decrease in loans receivable, also funded a $27.0 million decrease in borrowed funds.

Total liabilities increased $8.2 million, or 1.7%, to $488.9 million at March 31, 2014 from $480.8 million at December 31, 2013, resulting primarily from a $35.2 million increase in customer deposits, partially offset by a $27.0 million decrease in borrowed funds. Deposit growth consisted of a $7.0 million, or 6.8%, increase in noninterest bearing deposits and a $28.1 million, or 8.6%, increase in interest bearing deposits. The decrease in borrowed funds resulted from the repayment of a $5.0 million FHLB long term advance and $22.0 million of FHLB short term advances utilized to fund normal operating fluctuations.

Stockholders' equity increased $873,000 to $45.9 million at March 31, 2014 from $45.1 million at December 31, 2013. Book value and tangible book value per common share were $23.13 and $20.55, respectively, at March 31, 2014, compared to $22.66 and $20.04, respectively, at December 31, 2013.

At March 31, 2014, the Bank was considered "well-capitalized" under regulatory guidelines with a Tier 1 leverage ratio, Tier 1 risk-based capital ratio and total risk-based capital ratio of 8.68%, 14.56% and 15.82%, respectively, compared to 8.58%, 14.08% and 15.34%, respectively, at December 31, 2013.

RESULTS OF OPERATIONS

Comparison of Results for the Three Months Ended March 31, 2014 and 2013

General. Net income decreased $17,000, or 2.0%, to $841,000 for the three months ended March 31, 2014 from $858,000 for the same period in 2013. This decrease was the result of increases in noninterest expense and the provision for loan losses of $647,000 and $20,000, respectively, partially offset by increases in net interest income and noninterest income of $126,000 and $508,000, respectively, and a decrease in the provision for income taxes of $16,000.

Net interest income. Net interest income on a tax equivalent basis increased $130,000, or 3.2%, to $4.2 million for the three months ended March 31, 2014 from $4.1 million for the three months ended March 31, 2013. This increase can be attributed to a decrease in interest expense of $295,000, partially offset by a decrease in tax equivalent interest income of $165,000.

Interest income. Interest income on a tax equivalent basis decreased $165,000, or 3.2%, to $4.9 million for the three months ended March 31, 2014 compared to $5.1 million for the three months ended March 31, 2013. This decrease can be attributed to decreases in interest on loans, securities and interest-earning deposits with banks of $166,000, $14,000 and $3,000, respectively, partially offset by an increase in interest earned on federal bank stocks of $18,000. The decrease in interest income occurred despite a $15.9 million increase in average earning assets, which included an $8.9 million increase in average loans.

Tax equivalent interest earned on loans receivable decreased $166,000, or 3.9%, to $4.1 million for the three months ended March 31, 2014 compared to $4.3 million for the three months ended March 31, 2013. This decrease resulted from a 32 basis point decline in the average yield on loans to 4.73% for the three months ended March 31, 2014, versus 5.05% for the same period in 2013. This unfavorable yield variance accounted for a $275,000 decrease in interest income. Partially offsetting this unfavorable yield variance, average loans increased $8.9 million, or 2.6%, accounting for an increase of $109,000 in loan interest income. Management's strategy to increase loan production capacity, which includes the expansion of the corporate banking team and the projected entrance into new markets in the coming quarters, is key to overcoming the decrease in loan yields caused by an overall decline in market interest rates.

Tax equivalent interest earned on securities decreased $14,000, or 1.8%, to $779,000 for the three months ended March 31, 2014 as compared to $793,000 for the three months ended March 31, 2013. This decrease resulted from a 23 basis point decline in the average yield on securities to 2.59% for the three months ended March 31, 2014, versus 2.82% for the same period in 2013, due primarily to the sale of higher-yielding securities. This unfavorable yield variance accounted for a $67,000 decrease in interest income. Partially offsetting this unfavorable yield variance, the average balance of securities increased $8.0 million, or 7.0%, accounting for a $53,000 increase in interest income.

Interest expense. Interest expense decreased $295,000, or 28.5%, to $741,000 for the three months ended March 31, 2014 from $1.0 million for the same period in 2013. This decrease in interest expense can be attributed to a decrease in interest incurred on deposits and borrowed funds of $277,000 and $18,000, respectively.

Interest expense incurred on deposits decreased $277,000, or 33.1%, to $561,000 for the three months ended March 31, 2014 compared to $838,000 for the same period in 2013. The average cost of interest-bearing deposits decreased 38 basis points to 0.67% for the three months ended March 31, 2014, compared to 1.05% for the same period in 2013, resulting in a $314,000 decrease in interest expense. This decrease in the cost of deposits was primarily due to deposits repricing during 2013 and the first three months of 2014 in the prevailing low interest-rate environment.

Partially offsetting this favorable variance, the average balance of interest-bearing deposits increased $15.2 million, or 4.7%, to $340.4 million for the three months ended March 31, 2014, compared to $325.2 million for the same period in 2013 causing a $37,000 increase in interest expense. Average noninterest bearing deposits increased $6.4 million, or 6.4%, to $105.6 million from $99.2 million, facilitating the overall decline in the Corporation's cost of funds.

Interest expense incurred on borrowed funds decreased $18,000, or 9.1%, to $180,000 for the three months ended March 31, 2014, compared to $198,000 for the same period in the prior year. The average cost of long term borrowed funds decreased 61 basis points to 3.41% for the three months ended March 31, 2014, compared to 4.02% for the same period in 2013, causing a $28,000 decrease in interest expense. This resulted from the Corporation realizing a $29,000 reduction in interest expense related to capitalized interest costs on construction in progress. Additionally, the average balance of long term borrowed funds decreased $1.6 million, or 7.8%, accounting for a $15,000 decrease in interest expense. This resulted from the early repayment of a $5.0 million FHLB long term advance during the first quarter of 2014. The Corporation recognized a $550,000 prepayment penalty associated with this early repayment. Partially offsetting the favorable variance related to long term borrowings, the average balance of short term borrowed funds increased $6.2 million, which caused a $25,000 increase in interest expense. Short-term borrowings at March 31, 2014 included a $2.2 million advance on a line of credit during the third quarter of 2013 with a correspondent bank with a rate of 4.25%.

Average Balance Sheet and Yield/Rate Analysis. The following table sets forth, for the periods indicated, information concerning the total dollar amounts of interest income from interest-earning assets and the resulting average yields, the total dollar amounts of interest expense on interest-bearing liabilities and the resulting average costs, net interest income, interest rate spread and the net interest margin earned on average interest-earning assets. For purposes of this table, average loan balances include nonaccrual loans and exclude the allowance for loan losses and interest income includes accretion of net deferred loan fees. Interest and yields on tax-exempt loans and securities (tax-exempt for federal income tax purposes) are shown on a fully tax equivalent basis. The information is based on average daily balances during the periods presented.

(Dollar amounts in thousands)	Three months ended March 31,					
	2014			2013		
	Average Balance	Interest	Yield / Rate	Average Balance	Interest	Yield / Rate
Interest-earning assets:						
Loans, taxable	$333,655	$3,869	4.70 %	$326,023	$4,050	5.04 %
Loans, tax exempt	18,087	230	5.17 %	16,788	215	5.19 %
Total loans receivable	351,742	4,099	4.73 %	342,811	4,265	5.05 %
Securities, taxable	85,968	404	1.90 %	77,471	417	2.18 %
Securities, tax exempt	36,012	375	4.22 %	36,519	376	4.18 %
Total securities	121,980	779	2.59 %	113,990	793	2.82 %
Interest-earning deposits with banks	11,978	11	0.37 %	13,592	14	0.42 %
Federal bank stocks	3,469	35	4.09 %	2,859	17	2.41 %
Total interest-earning cash equivalents	15,447	46	1.21 %	16,451	31	0.76 %
Total interest-earning assets	489,169	4,924	4.08 %	473,252	5,089	4.36 %
Cash and due from banks	2,115			1,927		
Other noninterest-earning assets	30,366			26,251		
Total Assets	$521,650			$501,430		
Interest-bearing liabilities:						
Interest-bearing demand deposits	$225,174	$79	0.14 %	$198,227	$70	0.14 %
Time deposits	115,181	482	1.70 %	126,975	768	2.45 %
Total interest-bearing deposits	340,355	561	0.67 %	325,202	838	1.05 %
Borrowed funds, short-term	6,435	25	1.61 %	205	-	0.00 %
Borrowed funds, long-term (1)	18,441	155	3.41 %	20,000	198	4.02 %
Total borrowed funds	24,876	180	2.94 %	20,205	198	3.97 %
Total interest-bearing liabilities	365,231	741	0.82 %	345,407	1,036	1.22 %
Noninterest-bearing demand deposits	105,555	-	-	99,165	-	-

Funding and cost of funds	470,786	741	0.64 %	444,572	1,036	0.95 %
Other noninterest-bearing liabilities	4,605			5,073		
Total Liabilities	475,391			449,645		
Stockholders' Equity	46,259			51,785		
Total Liabilities and Stockholders' Equity	$521,650			$501,430		
Net interest income		$4,183			$4,053	
Interest rate spread (difference between weighted average rate on interest-earning assets and interest-bearing liabilities)			3.26 %			3.14 %
Net interest margin (net interest income as a percentage of average interest-earning assets)			3.47 %			3.47 %

(1) Interest on long-term borrowed funds was reduced by $29,000 related to capitalized interest costs on construction in progress.

Analysis of Changes in Net Interest Income. The following table analyzes the changes in interest income and interest expense in terms of: (1) changes in volume of interest-earning assets and interest-bearing liabilities and (2) changes in yields and rates. The table reflects the extent to which changes in the Corporation's interest income and interest expense are attributable to changes in volume (changes in volume multiplied by prior year rate), rate (change in rate multiplied by prior year volume) and changes attributable to the combined impact of volume/rate (change in rate multiplied by change in volume). The changes attributable to the combined impact of volume/rate are allocated on a consistent basis between the volume and rate variances. Changes in interest income on loans and securities reflect the changes in interest income on a fully tax equivalent basis.

(Dollar amounts in thousands)	Three months ended March 31, 2014 versus 2013 Increase (Decrease) due to		
	Volume	Rate	Total
Interest income:			
Loans	$ 109	$ (275)	$ (166)
Securities	53	(67)	(14)
Interest-earning deposits with banks	(2)	(1)	(3)
Federal bank stocks	4	14	18
Total interest-earning assets	164	(329)	(165)
Interest expense:			
Interest-bearing deposits	37	(314)	(277)
Borrowed funds, short-term	-	25	25
Borrowed funds, long-term	(15)	(28)	(43)
Total interest-bearing liabilities	22	(317)	(295)
Net interest income	$ 142	$ (12)	$ 130

Provision for loan losses. The Corporation records provisions for loan losses to maintain a level of total allowance for loan losses that management believes, to the best of its knowledge, covers all probable incurred losses estimable at each reporting date. Management considers historical loss experience, the present and prospective financial condition of borrowers, current conditions (particularly as they relate to markets where the Corporation originates loans), the status of nonperforming assets, the estimated underlying value of the collateral and other factors related to the collectability of the loan portfolio.

Information pertaining to the allowance for loan losses and nonperforming assets for the three months ended March 31, 2014 and 2013 is as follows:

(Dollar amounts in thousands)	At or for the three months ended

	March 31, 2014	2013
Balance at the beginning of the period	$ 4,869	$ 5,350
Provision for loan losses	163	143
Charge-offs	(132)	(37)
Recoveries	21	32
Balance at the end of the period	$ 4,921	$ 5,488
Nonperforming loans	$ 5,999	$ 6,828
Nonperforming assets	6,079	7,031
Nonperforming loans to total loans	1.71 %	1.98 %
Nonperforming assets to total assets	1.14 %	1.37 %
Allowance for loan losses to total loans	1.41 %	1.59 %
Allowance for loan losses to non-performing loans	82.03 %	80.37 %

28

Nonperforming loans decreased $829,000 to $6.0 million at March 31, 2014 from $6.8 million at March 31, 2013. The decrease in nonperforming loans was primarily due to a $941,000 partial charge-off in the second quarter of 2013 of a $3.4 million commercial real estate relationship identified as impaired. This loan had a specific reserve of $1.4 million. Also contributing to the decrease were principal reductions resulting from credit workouts and repayments. Of the $6.0 million in nonperforming loans, the Corporation continues to receive payments on $4.8 million. During the three months ended March 31, 2014, nonperforming loans increased $792,000, primarily due to a $724,000 commercial relationship being placed on nonaccrual status during the quarter after the Corporation received information from the borrower which reflected a weakened financial condition. This relationship consists of a commercial real estate loan secured by a commercial property and a commercial line of credit secured by accounts receivable, inventory and other business assets, both of which were considered impaired at March 31, 2014. The commercial real estate loan and commercial line of credit were assigned specific reserves of $38,000 and $235,000, respectively, during the quarter ended March 31, 2014.

As of March 31, 2014, the Corporation's classified and criticized assets amounted to $13.9 million, or 2.6% of total assets, with $11.9 million classified as substandard and $1.9 identified as special mention. This compares to classified and criticized assets of $12.7 million, or 2.4% of total assets, with $11.8 million classified as substandard and $930,000 identified as special mention at December 31, 2013. The overall increase in criticized and classified assets was primarily the result of two commercial loan relationships being downgraded to special mention during the quarter ended March 31, 2014.

The provision for loan losses increased $20,000, or 14.0%, to $163,000 for the three months ended March 31, 2014 from $143,000 for the same period in the prior year. While the Corporation allocated $273,000 of the allowance for loan losses to the aforementioned loans placed on nonaccrual status and recognized as impaired during the quarter, the allowance for loan losses allocated to the commercial real estate portfolio decreased due to a $6.2 million decrease in the portfolio balance and an improvement in the historical loss ratio.

Noninterest income. Noninterest income increased $508,000, or 54.6%, to $1.4 million for the three months ended March 31, 2014, compared to $931,000 for the same period in the prior year. This increase resulted from a $573,000 increase in net gains on the sale of securities. During the quarter ended March 31, 2014, the Corporation realized securities gains of $658,000 primarily related to a balance sheet management strategy whereby securities were sold to prepay a $5.0 million FHLB long term advance and associated securities gains were used to offset the impact of prepayment penalties associated with the early retirement of the advance. Excluding the net gains on securities, noninterest income decreased $65,000, or 7.7%, to $781,000 for the quarter ended March 31, 2014 from $846,000 for the same period in 2013 due to decreases in commissions on financial services and fees and service charges of $55,000 and $20,000, respectively.

Noninterest expense. Noninterest expense increased $647,000, or 18.1%, to $4.2 million for the three months ended March 31, 2014, compared to $3.6 million for the same period in the prior year. This increase in noninterest expense can be attributed primarily to an increase in other noninterest expense of $598,000, primarily related to a $550,000 prepayment penalty assessed on the aforementioned early retirement of debt. Also contributing to the increase in noninterest expense were increases in compensation and benefits and premises and equipment expense of $38,000 and $58,000, respectively, partially offset by decreases in intangible asset amortization, professional fees and FDIC expense of $16,000, $14,000 and $17,000, respectively. Noninterest expense for the first quarter of 2014 included $64,000 related to the Bank's new branch office in Saint Marys, Pennsylvania, which opened in October 2013.

Compensation and employee benefits expense increased $38,000, or 2.0%, to $1.9 million for the three months ended March 31, 2014. This increase can be primarily attributed to normal salary and wage increases and increased incentive compensation expense, partially offset by reduced retirement benefits cost resulting from the 2013 curtailment of the Bank's pension plan.

Premise and equipment expense increased $58,000, or 10.7%, to $600,000 for the three months ended March 31, 2014, compared to $542,000 for the same period in the prior year. Premise and equipment expense for the first quarter of 2014 included $25,000 related to the Bank's new branch office in Saint Marys, Pennsylvania.

Professional fees decreased $14,000, or 7.9%, to $163,000 for the three months ended March 31, 2014, compared to $177,000 for the same period in the prior year. This decrease can be primarily attributed to decreased information technology consulting costs.

The Corporation recognized $57,000 of core deposit intangible amortization expense during the first quarter of 2014 compared to $73,000 for the same period in the prior year. This amortization relates to a branch acquisition completed in the third quarter of 2009. Further discussion of goodwill and intangible assets related to the branch office acquisition can be found in the “Notes to Consolidated Financial Statements” beginning on page 6.

FDIC insurance decreased $17,000, or 16.2%, to $88,000 for the three months ended March 31, 2014, compared to $105,000 for the same period in the prior year. The decrease was primarily the result of a decrease in the Bank’s FDIC insurance assessment rate following a prior period decrease in the level of loans past due 30-89 days.

Provision for income taxes. The provision for income taxes decreased $16,000, or 6.9%, to $217,000 for the three months ended March 31, 2014 compared to $233,000 for the same period in the prior year. The Corporation’s effective tax rate decreased to 20.5% for the first quarter of 2014 from 21.4% for the same quarter in the prior year. The difference between the statutory rate of 34% and the Corporation’s effective tax rate of 20.5% for the quarter ended March 31, 2014 was due to tax-exempt income earned on certain tax-free loans and securities and bank-owned life insurance.

LIQUIDITY

The Corporation’s primary sources of funds generally have been deposits obtained through the offices of the Bank, borrowings from the FHLB and Federal Reserve, and amortization and prepayments of outstanding loans and maturing securities. During the three months ended March 31, 2014, the Corporation used its sources of funds primarily to fund security purchases and repay borrowed funds. As of March 31, 2014, the Corporation had outstanding loan commitments, including undisbursed loans and amounts available under credit lines, totaling $59.3 million, and standby letters of credit totaling $188,000.

At March 31, 2014, time deposits amounted to $120.6 million, or 25.8% of the Corporation’s total consolidated deposits, including approximately $44.4 million of which are scheduled to mature within the next year. Management of the Corporation believes (i) it has adequate resources to fund all of its commitments, (ii) all of its commitments will be funded as required by related maturity dates and (iii) based upon past experience and current pricing policies, it can adjust the rates of time deposits to retain a substantial portion of maturing liabilities if necessary.

Aside from liquidity available from customer deposits or through sales and maturities of securities, the Corporation has alternative sources of funds such as a term borrowing capacity from the FHLB and the Federal Reserve’s discount window. At March 31, 2014, the Corporation had borrowed funds of $17.2 million consisting of $15.0 million in long-term FHLB advances and a $2.2 million short-term advance on a line of credit with a correspondent bank. At March 31, 2014, the Corporation’s borrowing capacity with the FHLB, net of funds borrowed, was $146.5 million.

Management is not aware of any conditions, including any regulatory recommendations or requirements, which would adversely impact its liquidity or its ability to meet funding needs in the ordinary course of business.

RECENT REGULATORY DEVELOPMENTS

In July 2013, the Office of the Comptroller of the Currency and the other federal bank regulatory agencies issued a final rule that will revise their leverage and risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. Among other things, the rule established a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets), increases the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets), phases out certain kinds of intangibles and instruments treated as capital and assigns a higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance acquisition, development or construction of real property. The final rule also requires unrealized gains and losses on certain “available-for-sale” securities holdings to be included for purposes of calculating regulatory capital requirements unless a one-time opt-out is exercised. The rule limits a banking organization’s capital distributions and certain discretionary bonus payments if the banking organization does not hold a “capital conservation buffer” consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The new capital rules maintain the general structure of the prompt corrective action rules, but incorporate the new common equity Tier 1 capital requirement and the increased Tier 1 risk-weighted asset requirement into the prompt corrective action framework.

The final rule becomes effective for the Bank on January 1, 2015. The capital conservation buffer requirement will be phased in beginning January 1, 2016 and ending January 1, 2019, when the full capital conservation buffer requirement will be effective. The final rule also implements consolidated capital requirements for bank holding companies, such as the Corporation, effective January 1, 2015.

CRITICAL ACCOUNTING POLICIES

The Corporation’s consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and follow general practices within the industry in which it 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 third-party sources, when available. When third-party information is not available, valuation adjustments are estimated in good faith by management primarily though the use of internal cash flow modeling techniques.

The most significant accounting policies followed by the Corporation are presented in Note 1 to the consolidated financial statements included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2013. These policies, along with the disclosures presented in the other financial statement notes provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Management views critical accounting policies to be those which are highly dependent on subjective or complex judgments, estimates and assumptions and where changes in those estimates and assumptions could have a significant impact on the financial statements. Management has identified the following as critical accounting policies.

Allowance for loan losses. The Corporation considers that the determination of the allowance for loan losses involves a higher degree of judgment and complexity than its other significant accounting policies. The balance in the allowance for loan losses is determined based on management's review and evaluation of the loan portfolio in relation to past loss experience, the size and composition of the portfolio, current economic events and conditions and other pertinent factors, including management's assumptions as to future delinquencies, recoveries and losses. All of these factors may be susceptible to significant change. Among the many factors affecting the allowance for loan losses, some are quantitative while others require qualitative judgment. Although management believes its process for determining the allowance adequately considers all of the potential factors that could potentially result in credit losses, the process includes subjective elements and may be susceptible to significant change. To the extent actual outcomes differ from management's estimates, additional provisions for loan losses may be required that would adversely impact the Corporation's financial condition or earnings in future periods.

Other-than-temporary impairment. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic, market or other concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions and (4) whether the Corporation has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery.

Goodwill and intangible assets. Goodwill represents the excess cost over fair value of assets acquired in a business combination. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives to their estimated residual values. The impairment test is a two-step process that begins with an initial impairment evaluation. If the initial evaluation suggests that an impairment of the asset value exists, the second step is to determine the amount of the impairment. If the tests conclude that goodwill is impaired, the carrying value is adjusted and an impairment charge is recorded. As of November 30, 2013, the required annual impairment test of goodwill was performed and management concluded that no impairment existed as of that date.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk for the Corporation consists primarily of interest rate risk exposure and liquidity risk. Since virtually all of the interest-earning assets and interest-bearing liabilities are at the Bank, virtually all of the interest rate risk and liquidity risk lies at the Bank level. The Bank is not subject to currency exchange risk or commodity price risk, and has no trading portfolio, and therefore, is not subject to any trading risk. In addition, the Bank does not participate in hedging transactions such as interest rate swaps and caps. Changes in interest rates will impact both income and expense recorded and also the market value of long-term interest-earning assets and interest-bearing liabilities. Interest rate risk and liquidity risk management is performed at the Bank level. Although the Bank has a diversified loan portfolio, loans outstanding to individuals and businesses depend upon the local economic conditions in the immediate trade area.

One of the primary functions of the Corporation's asset/liability management committee is to monitor the level to which the balance sheet is subject to interest rate risk. The goal of the asset/liability committee is to manage the relationship between interest rate sensitive assets and liabilities, thereby minimizing the fluctuations in the net interest margin, which achieves consistent growth of net interest income during periods of changing interest rates.

Interest rate sensitivity is the result of differences in the amounts and repricing dates of the Bank's rate sensitive assets and rate sensitive liabilities. These differences, or interest rate repricing "gap", provide an indication of the extent that the Corporation's net interest income is affected by future changes in interest rates. A gap is considered positive when the amount of interest rate-sensitive assets exceeds the amount of interest rate-sensitive liabilities and is considered negative when the amount of interest rate-sensitive liabilities exceeds the amount of interest rate-sensitive assets. Generally, during a period of rising interest rates, a negative gap would adversely affect net interest income while a positive gap would result in an increase in net interest income. Conversely, during a period of falling interest rates, a negative gap would result in an increase in net interest income and a positive gap would adversely affect net interest income. The closer to zero that gap is maintained, generally, the lesser the impact of market interest rate changes on net interest income.

Assumptions about the timing and variability of cash flows are critical in gap analysis. Particularly important are the assumptions driving mortgage prepayments and the expected attrition of the core deposits portfolios. These assumptions are based on the Corporation's historical experience, industry standards and assumptions provided by a federal regulatory agency, which management believes most accurately represents the sensitivity of the Corporation's assets and liabilities to interest rate changes. As of March 31, 2014, the Corporation's interest-earning assets maturing or repricing within one year totaled $167.7 million while the Corporation's interest-bearing liabilities maturing or repricing within one-year totaled $142.9 million, providing an excess of interest-earning assets over interest-bearing liabilities of $24.8 million. At March 31, 2014, the percentage of the Corporation's assets to liabilities maturing or repricing within one year was 117.4%.

For more information, see "Market Risk Management" in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2013.

Item 4. Controls and Procedures

The Corporation maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Corporation's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Corporation's management, including its Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as appropriate, to allow timely decisions regarding required disclosure based on the definition of "disclosure controls and procedures" in Rule 13a-15(e).

As of March 31, 2014, the Corporation carried out an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's CEO and CFO, of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures. Based on the foregoing, the Corporation's CEO and CFO concluded that the Corporation's disclosure controls and procedures were effective. There have been no significant changes in the Corporation's internal controls or in other factors that could significantly affect the internal controls subsequent to the date the Corporation completed its evaluation.

There has been no change made in the Corporation's internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The Corporation is involved in various legal proceedings occurring in the ordinary course of business. It is the opinion of management, after consultation with legal counsel, that these matters will not materially affect the Corporation's consolidated financial position or results of operations.

Item 1A. Risk Factors

Not applicable.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

(a)	Not applicable.
(b)	Not applicable.

Item 6. Exhibits

Exhibit 31.1	Rule 13a-14(a) Certification of Principal Executive Officer
Exhibit 31.2	Rule 13a-14(a) Certification of Principal Financial Officer
Exhibit 32.1	CEO Certification Pursuant to 18 U.S.C. Section 1350
Exhibit 32.2	CFO Certification Pursuant to 18 U.S.C. Section 1350
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

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.

	EMCLAIRE FINANCIAL CORP	
Date: May 13, 2014	By:	/s/ William C. Marsh
	William C. Marsh Chairman of the Board, President and Chief Executive Officer	
Date: May 13, 2014	By:	/s/ Matthew J. Lucco
	Matthew J. Lucco Chief Financial Officer Treasurer	