

AMERISERV FINANCIAL INC /PA/

Form 10-Q

November 06, 2015

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

**FORM 10-Q**

x

**Quarterly Report Pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934**

For the period ended **September 30, 2015**

**Transition Report Pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934**

For the transition period from            to

Commission File Number **0-11204**

**AmeriServ Financial, Inc.**

(Exact name of registrant as specified in its charter)

Pennsylvania  
(State or other jurisdiction of  
incorporation or organization)

25-1424278  
(I.R.S. Employer  
Identification No.)

15907-0430

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Main & Franklin Streets,  
P.O. Box 430, Johnstown, PA

(Address of principal executive offices)

(Zip Code)

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

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

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

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

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

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

| Class                          | Outstanding at November 2, 2015 |
|--------------------------------|---------------------------------|
| Common Stock, par value \$0.01 | 18,870,811                      |

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## Item 1. Financial Statements

### AmeriServ Financial, Inc.

**CONSOLIDATED BALANCE SHEETS**

(In thousands except shares)

(Unaudited)

|  | September<br>30, 2015 | December<br>31, 2014 |
|--|-----------------------|----------------------|
| <b>ASSETS</b>  |                       |                      |
| Cash and due from depository institutions  | \$ 16,782             | \$ 23,780            |
| Interest bearing deposits  | 2,966                 | 2,952                |
| Short-term investments in money market funds   | 12,000                | 6,140                |
| Total cash and cash equivalents  | 31,748                | 32,872               |
| Investment securities:   |                       |                      |
| Available for sale   | 114,652               | 127,110              |
| Held to maturity (fair value \$20,771 on September 30, 2015 and \$20,213 on December 31, 2014) | 20,361                | 19,840               |
| Loans held for sale  | 2,913                 | 5,051                |
| Loans  | 865,890               | 827,634              |
| Less: Unearned income  | 590                   | 554                  |
| Allowance for loan losses  | 9,772                 | 9,623                |
| Net loans  | 855,528               | 817,457              |
| Premises and equipment, net  | 12,362                | 13,012               |
| Accrued interest income receivable   | 3,315                 | 3,127                |
| Goodwill   | 11,944                | 11,944               |
| Bank owned life insurance  | 37,266                | 37,417               |
| Net deferred tax asset   | 8,284                 | 9,548                |
| Federal Home Loan Bank stock   | 4,661                 | 4,048                |
| Federal Reserve Bank stock   | 2,125                 | 2,125                |
| Other assets   | 5,684                 | 5,712                |
| <b>TOTAL ASSETS</b>  | <b>\$ 1,110,843</b>   | <b>\$ 1,089,263</b>  |
| <b>LIABILITIES</b>   |                       |                      |
| Non-interest bearing deposits  | \$ 158,374            | \$ 167,551           |
| Interest bearing deposits  | 711,525               | 702,330              |
| Total deposits   | 869,899               | 869,881              |
| Short-term borrowings  | 52,988                | 38,880               |
| Advances from Federal Home Loan Bank   | 48,000                | 42,000               |
| Guaranteed junior subordinated deferrable interest debentures                                  | 13,085                | 13,085               |
| Total borrowed funds   | 114,073               | 93,965               |
| Other liabilities  | 7,463                 | 11,010               |
| <b>TOTAL LIABILITIES</b>   | <b>991,435</b>        | <b>974,856</b>       |
| <b>SHAREHOLDERS' EQUITY</b>  |                       |                      |
| Preferred stock, no par value; \$1,000 per share liquidation preference;                       | 21,000                | 21,000               |

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|   |             |             |
|---|-------------|-------------|
| 2,000,000 shares authorized; 21,000 shares issued and outstanding on September 30, 2015 and December 31, 2014   |             |             |
| Common stock, par value \$0.01 per share; 30,000,000 shares authorized; 26,488,630 shares issued and 18,870,811 outstanding on September 30, 2015; 26,402,707 shares issued and 18,784,888 outstanding on December 31, 2014 | 265         | 264         |
| Treasury stock at cost, 7,617,819 shares on September 30, 2015 and December 31, 2014  | (74,829 )   | (74,829 )   |
| Capital surplus   | 145,434     | 145,256     |
| Retained earnings   | 33,518      | 29,618      |
| Accumulated other comprehensive loss, net   | (5,980 )    | (6,902 )    |
| TOTAL SHAREHOLDERS' EQUITY  | 119,408     | 114,407     |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY  | \$1,110,843 | \$1,089,263 |

See accompanying notes to unaudited consolidated financial statements.

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(In thousands, except per share data)

(Unaudited)

|   | Three months ended |              | Nine months ended |               |
|---|--------------------|--------------|-------------------|---------------|
|   | September 30,      |              | September 30,     |               |
|   | 2015               | 2014         | 2015              | 2014          |
| <b>INTEREST INCOME</b>  |                    |              |                   |               |
| Interest and fees on loans                                    | \$9,718            | \$9,019      | \$28,654          | \$26,990      |
| Interest bearing deposits                                     | 1                  | 2            | 4                 | 6             |
| Short-term investments in money market funds                  | 3                  | 1            | 10                | 3             |
| Investment securities:  |                    |              |                   |               |
| Available for sale  | 790                | 859          | 2,480             | 2,688         |
| Held to maturity  | 155                | 138          | 451               | 410           |
| Total Interest Income   | 10,667             | 10,019       | 31,599            | 30,097        |
| <b>INTEREST EXPENSE</b>                                       |                    |              |                   |               |
| Deposits  | 1,174              | 1,237        | 3,519             | 3,688         |
| Short-term borrowings   | 37                 | 10           | 70                | 34            |
| Advances from Federal Home Loan Bank                          | 141                | 89           | 401               | 223           |
| Guaranteed junior subordinated deferrable interest debentures | 280                | 280          | 840               | 840           |
| Total Interest Expense  | 1,632              | 1,616        | 4,830             | 4,785         |
| <b>NET INTEREST INCOME</b>                                    | <b>9,035</b>       | <b>8,403</b> | <b>26,769</b>     | <b>25,312</b> |
| Provision for loan losses                                     | 300                |              | 750               |               |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>    | <b>8,735</b>       | <b>8,403</b> | <b>26,019</b>     | <b>25,312</b> |
| <b>NON-INTEREST INCOME</b>                                    |                    |              |                   |               |
| Trust and investment advisory fees                            | 2,085              | 1,807        | 6,276             | 5,787         |
| Service charges on deposit accounts                           | 441                | 507          | 1,289             | 1,486         |
| Net gains on sale of loans                                    | 178                | 275          | 594               | 547           |
| Mortgage related fees   | 87                 | 190          | 311               | 467           |
| Net realized gains (losses) on investment securities          | (36 )              |              | (8 )              | 177           |
| Bank owned life insurance                                     | 684                | 188          | 1,218             | 559           |
| Other income  | 576                | 626          | 1,739             | 1,740         |
| Total Non-Interest Income                                     | 4,015              | 3,593        | 11,419            | 10,763        |
| <b>NON-INTEREST EXPENSE</b>                                   |                    |              |                   |               |
| Salaries and employee benefits                                | 6,079              | 6,139        | 18,096            | 18,560        |
| Net occupancy expense   | 692                | 709          | 2,251             | 2,265         |
| Equipment expense   | 409                | 468          | 1,355             | 1,432         |
| Professional fees   | 1,206              | 1,360        | 3,692             | 4,132         |
| Supplies, postage and freight                                 | 181                | 196          | 534               | 566           |
| Miscellaneous taxes and insurance                             | 288                | 276          | 872               | 884           |
| Federal deposit insurance expense                             | 174                | 159          | 505               | 473           |
| Goodwill impairment charge                                    |                    | 669          |                   | 669           |

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|   |         |        |         |         |
|---|---------|--------|---------|---------|
| Other expense                               | 1,190   | 1,267  | 3,563   | 3,620   |
| Total Non-Interest Expense                  | 10,219  | 11,243 | 30,868  | 32,601  |
| PRETAX INCOME                               | 2,531   | 753    | 6,570   | 3,474   |
| Provision for income tax expense            | 698     | 388    | 1,947   | 1,200   |
| NET INCOME                                  | 1,833   | 365    | 4,623   | 2,274   |
| Preferred stock dividends                   | 52      | 53     | 157     | 158     |
| NET INCOME AVAILABLE TO COMMON SHAREHOLDERS | \$1,781 | \$312  | \$4,466 | \$2,116 |
| PER COMMON SHARE DATA:                      |         |        |         |         |
| Basic:                                      |         |        |         |         |
| Net income                                  | \$0.09  | \$0.02 | \$0.24  | \$0.11  |
| Average number of shares outstanding        | 18,869  | 18,795 | 18,860  | 18,792  |
| Diluted:                                    |         |        |         |         |
| Net income                                  | \$0.09  | \$0.02 | \$0.24  | \$0.11  |
| Average number of shares outstanding        | 18,951  | 18,908 | 18,928  | 18,916  |
| Cash dividends declared                     | \$0.01  | \$0.01 | \$0.03  | \$0.03  |

See accompanying notes to unaudited consolidated financial statements.



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**CONSOLIDATED STATEMENTS OF COMPREHENSIVE  
INCOME  
(In thousands)  
(Unaudited)**

|  | Three Months<br>Ended<br>September 30, |        | Nine Months Ended<br>September 30, |          |
|--|--|--------|------------------------------------|----------|
|  | 2015                                   | 2014   | 2015                               | 2014     |
| <b>COMPREHENSIVE INCOME</b>  |  |        |                                    |          |
| Net income   | \$1,833                                | \$ 365 | \$4,623                            | \$ 2,274 |
| Other comprehensive income, before tax:  |  |        |                                    |          |
| Pension obligation change for defined benefit plan   | 315                                    | 799    | 1,601                              | 1,191    |
| Income tax effect  | (107 )                                 | (272 ) | (545 )                             | (405 )   |
| Unrealized holding (gains) losses on available for sale securities arising during period               | 387                                    | (701 ) | (211 )                             | 850      |
| Income tax effect  | (131 )                                 | 238    | 72                                 | (289 )   |
| Reclassification adjustment for losses (gains) on available for sale securities included in net income | 36                                     |        | 8                                  | (177 )   |
| Income tax effect  | (12 )                                  |        | (3 )                               | 60       |
| Other comprehensive income   | 488                                    | 64     | 922                                | 1,230    |
| Comprehensive income   | \$2,321                                | \$ 429 | \$5,545                            | \$ 3,504 |

See accompanying notes to unaudited consolidated financial statements.

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(In thousands)

(Unaudited)

|   | Nine months ended<br>September 30, |            |
|---|------------------------------------|------------|
|   | 2015                               | 2014       |
| <b>OPERATING ACTIVITIES</b>   |                                    |            |
| Net income  | \$4,623                            | \$2,274    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |            |
| Provision for loan losses   | 750                                |            |
| Depreciation expense  | 1,346                              | 1,359      |
| Net amortization of investment securities   | 254                                | 283        |
| Net realized losses (gains) on investment securities available for sale           | 8                                  | (177 )     |
| Net gains on loans held for sale  | (594 )                             | (547 )     |
| Amortization of deferred loan fees  | (202 )                             | (198 )     |
| Origination of mortgage loans held for sale                                       | (39,214 )                          | (36,105 )  |
| Sales of mortgage loans held for sale   | 41,946                             | 36,090     |
| Increase in accrued interest income receivable                                    | (188 )                             | (372 )     |
| Decrease in accrued interest payable  | (105 )                             | (173 )     |
| Earnings on bank owned life insurance   | (514 )                             | (559 )     |
| Deferred income taxes   | 805                                | 139        |
| Stock based compensation expense  | 179                                | 56         |
| Goodwill impairment charge  |                                    | 669        |
| Other, net  | (2,536 )                           | (679 )     |
| Net cash provided by operating activities   | 6,558                              | 2,060      |
| <b>INVESTING ACTIVITIES</b>   |                                    |            |
| Purchases of investment securities available for sale                             | (9,408 )                           | (10,215 )  |
| Purchases of investment securities held to maturity                               | (4,795 )                           | (2,442 )   |
| Proceeds from sales of investment securities available for sale                   | 2,379                              | 5,242      |
| Proceeds from maturities of investment securities available for sale              | 19,063                             | 16,581     |
| Proceeds from maturities of investment securities held to maturity                | 4,233                              | 1,095      |
| Purchases of regulatory stock   | (14,111 )                          | (6,679 )   |
| Proceeds from redemption of regulatory stock                                      | 13,498                             | 6,329      |
| Long-term loans originated  | (185,864)                          | (126,805 ) |
| Principal collected on long-term loans  | 140,143                            | 91,886     |
| Loans purchased or participated   | (11,519 )                          | (4,247 )   |
| Loans sold or participated  | 18,443                             | 7,810      |
| Proceeds from sale of other real estate owned                                     | 478                                | 454        |
| Proceeds from life insurance policy   | 1,140                              |            |
| Purchases of premises and equipment   | (691 )                             | (1,643 )   |
| Net cash used in investing activities   | (27,011 )                          | (22,634 )  |
| <b>FINANCING ACTIVITIES</b>   |                                    |            |

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|  |          |           |
|--|----------|-----------|
| Net (decrease) increase in deposit balances                  | (56 )    | 17,828    |
| Net increase (decrease) in other short-term borrowings       | 14,108   | (15,117 ) |
| Principal borrowings on advances from Federal Home Loan Bank | 9,000    | 12,000    |
| Principal repayments on advances from Federal Home Loan Bank | (3,000 ) |           |
| Common stock dividends                                       | (566 )   | (563 )    |
| Preferred stock dividends                                    | (157 )   | (158 )    |
| Net cash provided by financing activities                    | 19,329   | 13,990    |
| NET DECREASE IN CASH AND CASH EQUIVALENTS                    | (1,124 ) | (6,584 )  |
| CASH AND CASH EQUIVALENTS AT JANUARY 1                       | 32,872   | 30,066    |
| CASH AND CASH EQUIVALENTS AT SEPTEMBER 30                    | \$31,748 | \$23,482  |

See accompanying notes to unaudited consolidated financial statements.

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# **NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

## **1. Principles of Consolidation**

The accompanying consolidated financial statements include the accounts of AmeriServ Financial, Inc. (the Company) and its wholly-owned subsidiaries, AmeriServ Financial Bank (the Bank), AmeriServ Trust and Financial Services Company (the Trust Company), and AmeriServ Life Insurance Company (AmeriServ Life). The Bank is a Pennsylvania state-chartered full service bank with 17 locations in Pennsylvania. The Trust Company offers a complete range of trust and financial services and administers assets valued at \$1.9 billion that are not reported on the Company's balance sheet at September 30, 2015. AmeriServ Life is a captive insurance company that engages in underwriting as a reinsurer of credit life and disability insurance.

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

## **2. Basis of Preparation**

The unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. In the opinion of management, all adjustments consisting of normal recurring entries considered necessary for a fair presentation have been included. They are not, however, necessarily indicative of the results of consolidated operations for a full-year.

For further information, refer to the consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

## **3. Recent Accounting Pronouncements**

In April 2015, the FASB issued ASU 2015-03, *Interest - Imputation of Interest (Subtopic 835-30)*, as part of its initiative to reduce complexity in accounting standards. To simplify presentation of debt issuance costs, the amendments in this Update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this Update. For public business entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016. An entity should apply the new guidance on a retrospective basis, wherein the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. This Update is not expected to have a significant impact on the Company's financial statements.

## 4. Earnings Per Common Share

Basic earnings per share include only the weighted average common shares outstanding. Diluted earnings per share include the weighted average common shares outstanding and any potentially dilutive common stock equivalent shares in the calculation. Treasury shares are treated as retired for earnings per share purposes. Options to purchase 74,304 common shares, at exercise prices ranging from \$3.20 to \$4.70, and 3,625 common shares, at exercise prices ranging from \$4.60 to \$5.22, were outstanding as of September 30, 2015 and 2014, respectively, but were not included in the computation of diluted earnings per common share because to do so would be antidilutive. Dividends on preferred shares are deducted from net income in the calculation of earnings per common share.

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|  | Three months ended<br>September 30,   |        | Nine months ended<br>September 30, |         |
|--|---------------------------------------|--------|------------------------------------|---------|
|  | 2015                                  | 2014   | 2015                               | 2014    |
|  | (In thousands, except per share data) |        |                                    |         |
| Numerator:   |                                       |        |                                    |         |
| Net income   | \$1,833                               | \$365  | \$4,623                            | \$2,274 |
| Preferred stock dividends                            | (52 )                                 | (53 )  | (157 )                             | (158 )  |
| Net income available to common shareholders          | \$1,781                               | \$312  | \$4,466                            | \$2,116 |
| Denominator:   |                                       |        |                                    |         |
| Weighted average common shares outstanding (basic)   | 18,869                                | 18,795 | 18,860                             | 18,792  |
| Effect of stock options                              | 82                                    | 113    | 68                                 | 124     |
| Weighted average common shares outstanding (diluted) | 18,951                                | 18,908 | 18,928                             | 18,916  |
| Earnings per common share:                           |                                       |        |                                    |         |
| Basic  | \$0.09                                | \$0.02 | \$0.24                             | \$0.11  |
| Diluted  | 0.09                                  | 0.02   | 0.24                               | 0.11    |

**5. Consolidated Statement of Cash Flows**

On a consolidated basis, cash and cash equivalents include cash and due from depository institutions, interest-bearing deposits and short-term investments in money market funds. The Company made \$1.1 million in income tax payments in both the first nine months of 2015 and 2014. The Company made total interest payments of \$4,935,000 in the first nine months of 2015 compared to \$4,958,000 in the same 2014 period. The Company had \$165,000 non-cash transfers to other real estate owned (OREO) in the first nine months of 2015 compared to \$455,000 non-cash transfers in the same 2014 period.

**6. Investment Securities**

The cost basis and fair values of investment securities are summarized as follows (in thousands):

**Investment securities available for sale (AFS):**

|                                      | September 30, 2015 |                              |                               |               |
|--------------------------------------|--------------------|------------------------------|-------------------------------|---------------|
|                                      | Cost<br>Basis      | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
| US Agency                            | \$2,900            | \$1                          | \$(1)                         | \$2,900       |
| US Agency mortgage-backed securities | 91,656             | 2,830                        | (144)                         | 94,342        |
| Corporate bonds                      | 17,505             | 71                           | (166)                         | 17,410        |

Total \$ 112,061 \$ 2,902 \$ (311 ) \$ 114,652

**Investment securities held to maturity (HTM):**

|                                      | September 30, 2015 |                              |                               |               |
|--------------------------------------|--------------------|------------------------------|-------------------------------|---------------|
|                                      | Cost<br>Basis      | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
| US Agency mortgage-backed securities | \$ 11,208          | \$ 374                       | \$ (4 )                       | \$ 11,578     |
| Taxable municipal                    | 4,153              | 93                           | (12 )                         | 4,234         |
| Corporate bonds and other securities | 5,000              | 17                           | (58 )                         | 4,959         |
| Total                                | \$ 20,361          | \$ 484                       | \$ (74 )                      | \$ 20,771     |

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TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****6. Investment Securities (continued)****Investment securities available for sale (AFS):**

|                                      | December 31, 2014 |                        |                         |            |
|--------------------------------------|-------------------|------------------------|-------------------------|------------|
|                                      | Cost Basis        | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| US Agency                            | \$ 5,931          | \$ 21                  | \$ (46 )                | \$ 5,906   |
| US Agency mortgage-backed securities | 102,888           | 3,197                  | (317 )                  | 105,768    |
| Corporate bonds                      | 15,497            | 61                     | (122 )                  | 15,436     |
| Total                                | \$ 124,316        | \$ 3,279               | \$ (485 )               | \$ 127,110 |

**Investment securities held to maturity (HTM):**

|                                      | December 31, 2014 |                        |                         |            |
|--------------------------------------|-------------------|------------------------|-------------------------|------------|
|                                      | Cost Basis        | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| US Agency mortgage-backed securities | \$ 12,481         | \$ 395                 | \$ (50 )                | \$ 12,826  |
| Taxable municipal                    | 3,364             | 74                     | (24 )                   | 3,414      |
| Corporate bonds and other securities | 3,995             | 6                      | (28 )                   | 3,973      |
| Total                                | \$ 19,840         | \$ 475                 | \$ (102 )               | \$ 20,213  |

Maintaining investment quality is a primary objective of the Company's investment policy which, subject to certain limited exceptions, prohibits the purchase of any investment security below a Moody's Investor's Service or Standard & Poor's rating of A. At September 30, 2015, 79.9% of the portfolio was rated AAA as compared to 84.1% at December 31, 2014. 5.7% of the portfolio was either rated below A or unrated at September 30, 2015. At September 30, 2015, the Company's consolidated investment securities portfolio had an effective duration of approximately 2.66 years.

The Company sold a \$1.9 million AFS security for the third quarter of 2015 resulting in \$36,000 of gross investment security losses and \$2.4 million of AFS securities for the first nine months of 2015 resulting in \$36,000 of gross investment security losses and \$28,000 of gross investment security gains. There were no sales of AFS securities in the third quarter of 2014. Total proceeds from the sale of AFS securities for the first nine months of 2014 were \$5.2 million resulting in \$182,000 of gross investment security gains and \$5,000 of gross security losses.

The book value of securities, both available for sale and held to maturity, pledged to secure public and trust deposits, and certain Federal Home Loan Bank borrowings was \$103,478,000 at September 30, 2015 and \$104,780,000 at December 31, 2014.



The following tables present information concerning investments with unrealized losses as of September 30, 2015 and December 31, 2014 (in thousands):

### Total investment securities:

|                                      | September 30, 2015  |                   |                     |                   |            |                   |
|--------------------------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|                                      | Less than 12 months |                   | 12 months or longer |                   | Total      |                   |
|                                      | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| US Agency                            | \$                  | \$                | \$399               | \$ (1 )           | \$399      | \$ (1 )           |
| Taxable municipal                    | 1,379               | (12 )             |                     |                   | 1,379      | (12 )             |
| US Agency mortgage-backed securities | 4,321               | (15 )             | 9,554               | (133 )            | 13,875     | (148 )            |
| Corporate bonds and other securities | 5,904               | (96 )             | 6,870               | (128 )            | 12,774     | (224 )            |
| Total                                | \$11,604            | \$ (123 )         | \$16,823            | \$ (262 )         | \$28,427   | \$ (385 )         |

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TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****6. Investment Securities (continued)****Total investment securities:**

|                                      | December 31, 2014   |                   |                     |                   |            |                   |
|--------------------------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|                                      | Less than 12 months |                   | 12 months or longer |                   | Total      |                   |
|                                      | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| US Agency                            | \$996               | \$ (4 )           | \$2,858             | \$ (42 )          | \$3,854    | \$ (46 )          |
| US Agency mortgage-backed securities | 2,826               | (13 )             | 20,408              | (354 )            | 23,234     | (367 )            |
| Taxable municipal                    | 150                 | (1 )              | 988                 | (23 )             | 1,138      | (24 )             |
| Corporate bonds and other securities | 2,960               | (43 )             | 8,891               | (107 )            | 11,851     | (150 )            |
| Total                                | \$6,932             | \$ (61 )          | \$33,145            | \$ (526 )         | \$40,077   | \$ (587 )         |

The unrealized losses are primarily a result of increases in market yields from the time of purchase. In general, as market yields rise, the value of securities will decrease; as market yields fall, the fair value of securities will increase. There are 29 positions that are considered temporarily impaired at September 30, 2015. Management generally views changes in fair value caused by changes in interest rates as temporary; therefore, these securities have not been classified as other-than-temporarily impaired. Management has also concluded that based on current information we expect to continue to receive scheduled interest payments as well as the entire principal balance. Furthermore, management does not intend to sell these securities and does not believe it will be required to sell these securities before they recover in value.

Contractual maturities of securities at September 30, 2015 are shown below (in thousands). Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without prepayment penalties.

**Total investment securities:**

|                                    | September 30, 2015 |            |                  |            |
|------------------------------------|--------------------|------------|------------------|------------|
|                                    | Available for sale |            | Held to maturity |            |
|                                    | Cost Basis         | Fair Value | Cost Basis       | Fair Value |
| Within 1 year                      | \$ 1,000           | \$ 998     | \$ 1,000         | \$ 997     |
| After 1 year but within 5 years    | 12,266             | 12,335     | 2,000            | 1,945      |
| After 5 years but within 10 years  | 21,133             | 21,524     | 6,767            | 6,851      |
| After 10 years but within 15 years | 46,838             | 48,068     | 1,397            | 1,389      |
| Over 15 years                      | 30,824             | 31,727     | 9,197            | 9,589      |
| Total                              | \$ 112,061         | \$ 114,652 | \$ 20,361        | \$ 20,771  |



TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****7. Loans**

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

|   | September<br>30, 2015 | December<br>31, 2014 |
|---|-----------------------|----------------------|
| Commercial                              | \$ 169,472            | \$ 139,126           |
| Commercial loans secured by real estate | 418,168               | 410,329              |
| Real estate mortgage                    | 257,530               | 258,616              |
| Consumer                                | 20,130                | 19,009               |
| Loans, net of unearned income           | \$ 865,300            | \$ 827,080           |

Loan balances at September 30, 2015 and December 31, 2014 are net of unearned income of \$590,000 and \$554,000, respectively. Real estate-construction loans comprised 3.4% and 3.5% of total loans, net of unearned income at September 30, 2015 and December 31, 2014, respectively.

**8. Allowance for Loan Losses**

The following tables summarize the rollforward of the allowance for loan losses by portfolio segment for the three and nine month periods ending September 30, 2015 and 2014 (in thousands).

|   | Three months ended September 30, 2015, |             |            |                       | Balance at               |
|---|--|-------------|------------|-----------------------|--------------------------|
|   | Balance<br>at<br>June 30,<br>2015      | Charge-Offs | Recoveries | Provision<br>(Credit) | September<br>30,<br>2015 |
| Commercial                              | \$ 3,171                               | \$ (35 )    | \$ 21      | \$ (47 )              | \$ 3,110                 |
| Commercial loans secured by real estate | 4,140                                  | (235 )      | 3          | 113                   | 4,021                    |
| Real estate mortgage                    | 1,321                                  | (85 )       | 98         | 58                    | 1,392                    |
| Consumer                                | 201                                    | (18 )       | 6          | 88                    | 277                      |
| Allocation for general risk             | 884                                    |             |            | 88                    | 972                      |
| Total                                   | \$ 9,717                               | \$ (373 )   | \$ 128     | \$ 300                | \$ 9,772                 |

|   | Three months ended September 30, 2014, |             |            |                       | Balance at               |
|---|--|-------------|------------|-----------------------|--------------------------|
|   | Balance at<br>June 30,<br>2014         | Charge-Offs | Recoveries | Provision<br>(Credit) | September<br>30,<br>2014 |
| Commercial                              | \$ 3,254                               | \$          | \$ 6       | \$ 35                 | \$ 3,295                 |
| Commercial loans secured by real estate | 4,475                                  | (506 )      | 24         | (78 )                 | 3,915                    |

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|                             |           |           |       |       |          |
|-----------------------------|-----------|-----------|-------|-------|----------|
| Real estate mortgage        | 1,301     | (103 )    | 29    | 115   | 1,342    |
| Consumer                    | 145       | (24 )     | 6     | 24    | 151      |
| Allocation for general risk | 975       |           |       | (96 ) | 879      |
| Total                       | \$ 10,150 | \$ (633 ) | \$ 65 | \$    | \$ 9,582 |

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TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****8. Allowance for Loan Losses (continued)**

|   | Nine months ended September 30, 2015, |             |            |                    | Balance at         |
|---|---------------------------------------|-------------|------------|--------------------|--------------------|
|   | Balance at                            | Charge-Offs | Recoveries | Provision (Credit) | September 30, 2015 |
|   | December 31, 2014                     |             |            |                    |                    |
| Commercial                              | \$ 3,262                              | \$ (156 )   | \$ 35      | \$ (31 )           | \$ 3,110           |
| Commercial loans secured by real estate | 3,902                                 | (250 )      | 54         | 315                | 4,021              |
| Real estate mortgage                    | 1,310                                 | (376 )      | 153        | 305                | 1,392              |
| Consumer                                | 190                                   | (81 )       | 20         | 148                | 277                |
| Allocation for general risk             | 959                                   |             |            | 13                 | 972                |
| Total                                   | \$ 9,623                              | \$ (863 )   | \$ 262     | \$ 750             | \$ 9,772           |

|   | Nine months ended September 30, 2014, |             |            |                    | Balance at         |
|---|---------------------------------------|-------------|------------|--------------------|--------------------|
|   | Balance at                            | Charge-Offs | Recoveries | Provision (Credit) | September 30, 2014 |
|   | December 31, 2013                     |             |            |                    |                    |
| Commercial                              | \$ 2,844                              | \$ (72 )    | \$ 111     | \$ 412             | \$ 3,295           |
| Commercial loans secured by real estate | 4,885                                 | (572 )      | 196        | (594 )             | 3,915              |
| Real estate mortgage                    | 1,260                                 | (176 )      | 54         | 204                | 1,342              |
| Consumer                                | 136                                   | (82 )       | 19         | 78                 | 151                |
| Allocation for general risk             | 979                                   |             |            | (100 )             | 879                |
| Total                                   | \$ 10,104                             | \$ (902 )   | \$ 380     | \$                 | \$ 9,582           |

As a result of successful ongoing problem credit resolution efforts, including a reduction in classified loans, the Company achieved further asset quality improvements in 2015 and 2014, specifically in the commercial and commercial loans secured by real estate portfolios. There was no provision for loan losses in the first nine months of 2014, but the Company recorded a \$750,000 provision in the first nine months of 2015 which was needed to support loan growth.

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

| At September 30, 2015 |                 |          |                  |       |
|-----------------------|-----------------|----------|------------------|-------|
| Commercial            | Commercial Real | Consumer | Allocation       | Total |
| Loans Secured by Real | Estate Mortgage |          | for General Risk |       |

|                                       | Estate    |           |           |          |       |           |
|---------------------------------------|-----------|-----------|-----------|----------|-------|-----------|
| Loans:                                |           |           |           |          |       |           |
| Individually evaluated for impairment | \$473     | \$422     | \$        | \$70     |       | \$965     |
| Collectively evaluated for impairment | 168,999   | 417,746   | 257,530   | 20,060   |       | 864,335   |
| Total loans                           | \$169,472 | \$418,168 | \$257,530 | \$20,130 |       | \$865,300 |
| Allowance for loan losses:            |           |           |           |          |       |           |
| Specific reserve allocation           | \$195     | \$259     | \$        | \$70     | \$    | \$524     |
| General reserve allocation            | 2,915     | 3,762     | 1,392     | 207      | 972   | 9,248     |
| Total allowance for loan losses       | \$3,110   | \$4,021   | \$1,392   | \$277    | \$972 | \$9,772   |

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|                                       | At December 31, 2014 |            |            |           |            |            |
|---------------------------------------|----------------------|------------|------------|-----------|------------|------------|
|                                       | Commercial           | Commercial | Real       | Consumer  | Allocation | Total      |
|                                       | Loans                | Loans      | Estate     | Loans     | for        |            |
|                                       | Secured              | Secured    | Mortgage   |           | General    |            |
|                                       | by Real              | by Real    |            |           | Risk       |            |
|                                       | Estate               | Estate     |            |           |            |            |
| Loans:                                |                      |            |            |           |            |            |
| Individually evaluated for impairment | \$                   | \$ 989     | \$         | \$        |            | \$ 989     |
| Collectively evaluated for impairment | 139,126              | 409,340    | 258,616    | 19,009    |            | 826,091    |
| Total loans                           | \$ 139,126           | \$ 410,329 | \$ 258,616 | \$ 19,009 |            | \$ 827,080 |
| Allowance for loan losses:            |                      |            |            |           |            |            |
| Specific reserve allocation           | \$                   | \$ 520     | \$         | \$        | \$         | \$ 520     |
| General reserve allocation            | 3,262                | 3,382      | 1,310      | 190       | 959        | 9,103      |
| Total allowance for loan losses       | \$ 3,262             | \$ 3,902   | \$ 1,310   | \$ 190    | \$ 959     | \$ 9,623   |

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

Management evaluates for possible impairment any individual loan in the commercial or commercial real estate segment with a loan balance in excess of \$100,000 that is in nonaccrual status or classified as a Troubled Debt Restructure (TDR). Loans are considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. The Company does not separately evaluate individual consumer and residential mortgage loans for impairment, unless such loans are part of a larger relationship that is impaired, or are classified as a TDR.

Once the determination has been made that a loan is impaired, the determination of whether a specific allocation of the allowance is necessary is measured by comparing the recorded investment in the loan to the fair value of the loan



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

The need for an updated appraisal on collateral dependent loans is determined on a case-by-case basis. The useful life of an appraisal or evaluation will vary depending upon the circumstances of the property and the economic conditions in the marketplace. A new appraisal is not required if there is an existing appraisal which, along with other information, is sufficient to determine a reasonable value for the property and to

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****8. Allowance for Loan Losses (continued)**

support an appropriate and adequate allowance for loan losses. At a minimum, annual documented reevaluation of the property is completed by the Bank's internal Assigned Risk Department to support the value of the property.

When reviewing an appraisal associated with an existing collateral real estate dependent transaction, the Bank's internal Assigned Risk Department must determine if there have been material changes to the underlying assumptions in the appraisal which affect the original estimate of value. Some of the factors that could cause material changes to reported values include:

the passage of time;  
the volatility of the local market;  
the availability of financing;  
natural disasters;

the inventory of competing properties;

new improvements to, or lack of maintenance of, the subject property or competing properties upon physical inspection by the Bank;

changes in underlying economic and market assumptions, such as material changes in current and projected vacancy, absorption rates, capitalization rates, lease terms, rental rates, sales prices, concessions, construction overruns and delays, zoning changes, etc.; and/or

environmental contamination.

The value of the property is adjusted to appropriately reflect the above listed factors and the value is discounted to reflect the value impact of a forced or distressed sale, any outstanding senior liens, any outstanding unpaid real estate taxes, transfer taxes and closing costs that would occur with sale of the real estate. If the Assigned Risk Department personnel determine that a reasonable value cannot be derived based on available information, a new appraisal is ordered. The determination of the need for a new appraisal, versus completion of a property valuation by the Bank's Assigned Risk Department personnel rests with the Assigned Risk Department and not the originating account officer.

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

|   | September 30, 2015                     |   |                      |                     |                          |
|---|--|---|----------------------|---------------------|--------------------------|
|   | Impaired Loans with Specific Allowance | Impaired Loans with no Specific Allowance | Total Impaired Loans |                     |                          |
|   | Recorded Investment                    | Related Allowance                         | Recorded Investment  | Recorded Investment | Unpaid Principal Balance |
| Commercial                              | \$ 473                                 | \$ 195                                    | \$                   | \$ 473              | \$ 476                   |
| Commercial loans secured by real estate | 378                                    | 259                                       | 44                   | 422                 | 507                      |
| Consumer                                | 70                                     | 70  |                      | 70                  | 70                       |

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Total impaired loans \$ 921 \$ 524 \$ 44 \$ 965 \$ 1,053

December 31, 2014

|   | Impaired Loans with Specific Allowance | Impaired Loans with no Specific Allowance | Total Impaired Loans | Unpaid Principal Balance |
|---|--|---|----------------------|--------------------------|
|   | Recorded Investment                    | Recorded Investment                       | Recorded Investment  | Recorded Investment      |
|   | Related Allowance                      |   |                      |                          |
| Commercial loans secured by real estate | \$ 989                                 | \$ 520                                    | \$                   | \$ 989                   |
| Total impaired loans                    | \$ 989                                 | \$ 520                                    | \$                   | \$ 989                   |

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TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****8. Allowance for Loan Losses (continued)**

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

|  | Three months ended<br>September 30, |          | Nine months ended<br>September 30, |          |
|--|-------------------------------------|----------|------------------------------------|----------|
|  | 2015                                | 2014     | 2015                               | 2014     |
| Average loan balance:  |                                     |          |                                    |          |
| Commercial   | \$ 347                              | \$       | \$ 189                             | \$       |
| Commercial loans secured by real estate                      | 966                                 | 1,897    | 1,583                              | 2,012    |
| Consumer   | 35                                  |          | 23                                 |          |
| Average investment in impaired loans                         | \$ 1,348                            | \$ 1,897 | \$ 1,795                           | \$ 2,012 |
| Interest income recognized:                                  |                                     |          |                                    |          |
| Commercial   | \$ 7                                | \$       | \$ 17                              | \$       |
| Commercial loans secured by real estate                      | 5                                   | 4        | 15                                 | 6        |
| Consumer   |                                     |          | 1                                  |          |
| Interest income recognized on a cash basis on impaired loans | \$ 12                               | \$ 4     | \$ 33                              | \$ 6     |

Management uses a nine point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized. The first five Pass categories are aggregated, while the Pass-6, Special Mention, Substandard and Doubtful categories are disaggregated to separate pools. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due, or for which any portion of the loan represents a specific allocation of the allowance for loan losses are placed in Substandard or Doubtful.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Company has a structured loan rating process, which dictates that, at a minimum, credit reviews are mandatory for all commercial and commercial mortgage loan relationships with aggregate balances in excess of \$250,000 within a 12-month period. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as bankruptcy, delinquency, or death occurs to raise awareness of a possible credit event. The Company's commercial relationship managers are responsible for the timely and accurate risk rating of the loans in their portfolios at origination and on an ongoing basis. Risk ratings are assigned by the account officer, but require independent review and rating concurrence from the Company's internal Loan Review Department. The Loan Review Department is an experienced independent function which reports directly to the Board's Audit Committee. The scope of commercial portfolio coverage by the Loan Review Department is defined and presented to the Audit Committee for approval on an annual basis. The approved scope of coverage for 2015 required review of a minimum range of 50% to 55% of the commercial loan portfolio.

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

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

|   | September 30, 2015 |                    |             |          |            |
|---|--------------------|--------------------|-------------|----------|------------|
|   | Pass               | Special<br>Mention | Substandard | Doubtful | Total      |
| Commercial                              | \$ 166,822         | \$ 744             | \$ 1,778    | \$ 128   | \$ 169,472 |
| Commercial loans secured by real estate | 412,270            | 2,942              | 2,937       | 19       | 418,168    |
| Total                                   | \$ 579,092         | \$ 3,686           | \$ 4,715    | \$ 147   | \$ 587,640 |

|   | December 31, 2014 |                    |             |          |            |
|---|-------------------|--------------------|-------------|----------|------------|
|   | Pass              | Special<br>Mention | Substandard | Doubtful | Total      |
| Commercial                              | \$ 132,665        | \$ 161             | \$ 6,164    | \$ 136   | \$ 139,126 |
| Commercial loans secured by real estate | 406,195           | 620                | 3,238       | 276      | 410,329    |
| Total                                   | \$ 538,860        | \$ 781             | \$ 9,402    | \$ 412   | \$ 549,455 |

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

|                      | September 30, 2015 |                |
|----------------------|--------------------|----------------|
|                      | Performing         | Non-Performing |
| Real estate mortgage | \$ 255,901         | \$ 1,629       |
| Consumer             | 20,060             | 70             |
| Total                | \$ 275,961         | \$ 1,699       |

|                      | December 31, 2014 |                |
|----------------------|-------------------|----------------|
|                      | Performing        | Non-Performing |
| Real estate mortgage | \$ 257,199        | \$ 1,417       |
| Consumer             | 19,009            |                |
| Total                | \$ 276,208        | \$ 1,417       |

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Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans (in thousands).

|   |  | September 30, 2015 |                  |                  |                  |                  |                  | 90                               |
|---|--|--------------------|------------------|------------------|------------------|------------------|------------------|----------------------------------|
|   |  | Current            | 30 Days Past Due | 59 Days Past Due | 60 Days Past Due | 89 Days Past Due | 90 Days Past Due | Days Past Due and Still Accruing |
| Commercial                              |  | \$ 168,872         | \$ 600           | \$               | \$               | \$ 600           | \$ 169,472       | \$                               |
| Commercial loans secured by real estate |  | 418,168            |                  |                  |                  |                  | 418,168          |                                  |
| Real estate mortgage                    |  | 254,125            | 1,887            | 801              | 717              | 3,405            | 257,530          |                                  |
| Consumer                                |  | 19,607             | 446              | 77               |                  | 523              | 20,130           |                                  |
| Total                                   |  | \$ 860,772         | \$ 2,933         | \$ 878           | \$ 717           | \$ 4,528         | \$ 865,300       | \$                               |

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|   | December 31, 2014 |                  |                  |                  |                  |                  |                      |                                     |
|---|-------------------|------------------|------------------|------------------|------------------|------------------|----------------------|-------------------------------------|
|   | Current           | 30 Days Past Due | 59 Days Past Due | 60 Days Past Due | 89 Days Past Due | 90 Days Past Due | Total Past Due Loans | 90 Days Past Due and Still Accruing |
| Commercial                              | \$ 139,126        | \$               | \$               | \$               | \$               | \$               | \$ 139,126           | \$                                  |
| Commercial loans secured by real estate | 410,049           | 280              |                  |                  |                  | 280              | 410,329              |                                     |
| Real estate mortgage                    | 255,021           | 2,196            | 332              | 1,067            | 3,595            | 258,616          |                      |                                     |
| Consumer                                | 18,927            | 74               | 8                |                  | 82               | 19,009           |                      |                                     |
| Total                                   | \$ 823,123        | \$ 2,550         | \$ 340           | \$ 1,067         | \$ 3,957         | \$ 827,080       | \$                   |                                     |

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

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate.

For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are complemented by consideration of other qualitative factors.

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

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



evaluated quarterly (and revised if necessary) by the Company's management to establish allocations which accommodate each of the listed risk factors.

Pass rated credits are segregated from Criticized and Classified credits for the application of qualitative factors.

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

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****9. Non-performing Assets Including Troubled Debt Restructurings (TDR)**

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

|  | September<br>30, 2015 | December<br>31, 2014 |
|--|-----------------------|----------------------|
| <u>Non-accrual loans</u>   |                       |                      |
| Commercial   | \$ 162                | \$                   |
| Commercial loans secured by real estate  | 19                    | 778                  |
| Real estate mortgage   | 1,629                 | 1,417                |
| Total  | 1,810                 | 2,195                |
| <u>Other real estate owned</u>   |                       |                      |
| Commercial loans secured by real estate  |                       | 384                  |
| Real estate mortgage   | 172                   | 128                  |
| Total  | 172                   | 512                  |
| TDR s not in non-accrual   | 312                   | 210                  |
| Total non-performing assets including TDR  | \$ 2,294              | \$ 2,917             |
| Total non-performing assets as a percent of loans, net of unearned income, and other real estate owned | 0.27 %                | 0.35 %               |

The Company had no loans past due 90 days or more for the periods presented which were accruing interest.

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

|   | Three months ended<br>September 30, |       | Nine months ended<br>September 30, |        |
|---|-------------------------------------|-------|------------------------------------|--------|
|   | 2015                                | 2014  | 2015                               | 2014   |
| Interest income due in accordance with original terms | \$ 25                               | \$ 39 | \$ 73                              | \$ 106 |
| Interest income recorded                              |                                     |       |                                    |        |
| Net reduction in interest income                      | \$ 25                               | \$ 39 | \$ 73                              | \$ 106 |

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

To be considered a TDR, both of the following criteria must be met:

the borrower must be experiencing financial difficulties; and  
the Bank, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that would not otherwise be considered.

Factors that indicate a borrower is experiencing financial difficulties include, but are not limited to:

the borrower is currently in default on their loan(s);  
the borrower has filed for bankruptcy;

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the borrower has insufficient cash flows to service their loan(s); and the borrower is unable to obtain refinancing from other sources at a market rate similar to rates available to a non-troubled debtor.

Factors that indicate that a concession has been granted include, but are not limited to:

the borrower is granted an interest rate reduction to a level below market rates for debt with similar risk; or the borrower is granted a material maturity date extension, or extension of the amortization plan to provide payment relief. For purposes of this policy, a material maturity date extension will generally include any maturity date extension, or the aggregate of multiple consecutive maturity date extensions, that exceed 120 days. A restructuring that results in an insignificant delay in payment, i.e. 120 days or less, is not necessarily a TDR. Insignificant payment delays occur when the amount of the restructured payments subject to the delay is insignificant relative to the unpaid principal or collateral value, and will result in an insignificant shortfall in the originally scheduled contractual amount due, and/or the delay in timing of the restructured payment period is insignificant relative to the frequency of payments, the original maturity or the original amortization.

The determination of whether a restructured loan is a TDR requires consideration of all of the facts and circumstances surrounding the modification. No single factor is determinative of whether a restructuring is a TDR. An overall general decline in the economy or some deterioration in a borrower's financial condition does not automatically mean that the borrower is experiencing financial difficulty. Accordingly, determination of whether a modification is a TDR involves a large degree of judgment.

The following table details the loans modified as TDRs during the three month period ended September 30, 2015 (dollars in thousands).

| Loans in accrual status | # of Loans | Current Balance | Concession Granted         |
|-------------------------|------------|-----------------|----------------------------|
| Commercial loan         | 1          | \$ 162          | Extension of maturity date |

The Company had no loans modified as TDRs during the third quarter of 2014.

The following table details the loans modified as TDRs during the nine month period ended September 30, 2015 (dollars in thousands).

| Loans in accrual status | # of Loans | Current Balance | Concession Granted         |
|-------------------------|------------|-----------------|----------------------------|
| Commercial loan         | 2          | \$ 366          | Extension of maturity date |

The following table details the loans modified as TDRs during the nine month period ended September 30, 2014 (dollars in thousands).

| Loans in non-accrual status            | # of Loans | Current Balance | Concession Granted         |
|--|------------|-----------------|----------------------------|
| Commercial loan secured by real estate | 1          | \$ 138          | Extension of maturity date |

In all instances where loans have been modified in troubled debt restructurings the pre- and post-modified balances are the same. The specific ALL reserve for loans modified as TDR s was \$524,000 and \$503,000 as of September 30, 2015 and 2014, respectively. All TDR s are individually evaluated for impairment and a related allowance is recorded, as needed.

Once a loan is classified as a TDR, this classification will remain until documented improvement in the financial position of the borrower supports confidence that all principal and interest will be paid according to terms. Additionally, the customer must have re-established a track record of timely payments according to the restructured contract terms for a minimum of six consecutive months prior to consideration for removing the

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****9. Non-performing Assets Including Troubled Debt Restructurings (TDR) (continued)**

loan from non-accrual TDR status. However, a loan will continue to be on non-accrual status until, consistent with our policy, the borrower has made a minimum of an additional six consecutive monthly payments in accordance with the terms of the loan.

The Company had no loans that were classified as TDR s or were subsequently modified during each 12-month period prior to the current reporting periods, which begin January 1, 2015 and 2014 (nine month periods) and July 1, 2015 and 2014 (three month periods), respectively, and that subsequently defaulted during these reporting periods.

The Company is unaware of any additional loans which are required to either be charged-off or added to the non-performing asset totals disclosed above.

**10. Federal Home Loan Bank Borrowings**

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

| Type                    | At September 30, 2015 |            |                       |
|-------------------------|-----------------------|------------|-----------------------|
|                         | Maturing              | Amount     | Weighted Average Rate |
| Open Repo Plus Advances | Overnight             | \$ 52,988  | 0.34 %                |
|                         | 2015                  | 1,000      | 0.50                  |
|                         | 2016                  | 12,000     | 0.81                  |
|                         | 2017                  | 12,000     | 1.06                  |
|                         | 2018                  | 12,000     | 1.48                  |
|                         | 2019 and over         | 11,000     | 1.72                  |
| Total advances          |                       | 48,000     | 1.24                  |
| Total FHLB borrowings   |                       | \$ 100,988 | 0.77 %                |

| Type                    | At December 31, 2014 |           |                       |
|-------------------------|----------------------|-----------|-----------------------|
|                         | Maturing             | Amount    | Weighted Average Rate |
| Open Repo Plus Advances | Overnight            | \$ 38,880 | 0.27 %                |
|                         | 2015                 | 4,000     | 0.52                  |
|                         | 2016                 | 12,000    | 0.81                  |

|                       |               |           |        |
|-----------------------|---------------|-----------|--------|
|                       | 2017          | 12,000    | 1.06   |
|                       | 2018          | 10,000    | 1.51   |
|                       | 2019 and over | 4,000     | 1.88   |
| Total advances        |               | 42,000    | 1.12   |
| Total FHLB borrowings |               | \$ 80,880 | 0.71 % |

The rate on Open Repo Plus advances can change daily, while the rates on the advances are fixed until the maturity of the advance. All FHLB stock along with an interest in certain residential mortgage and CRE loans with an aggregate statutory value equal to the amount of the advances are pledged as collateral to the FHLB of Pittsburgh to support these borrowings.

## 11. Preferred Stock

On August 11, 2011, pursuant to the Small Business Lending Fund (SBLF), the Company issued and sold to the US Treasury 21,000 shares of its Senior Non-Cumulative Perpetual Preferred Stock, Series E (Series E Preferred Stock) for the aggregate proceeds of \$21 million. The SBLF is a voluntary program sponsored by the US Treasury that encourages small business lending by providing capital to qualified community banks at favorable rates. The Company used the proceeds from the Series E Preferred Stock issued to the US Treasury to repurchase all 21,000 shares of its outstanding preferred shares previously issued to the US Treasury under the Capital Purchase Program.

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****11. Preferred Stock (continued)**

The Series E Preferred Stock has an aggregate liquidation preference of approximately \$21 million and qualifies as Tier 1 Capital for regulatory purposes. The terms of the Series E Preferred Stock provide for the payment of non-cumulative dividends on a quarterly basis. Since January 1, 2014, the dividend rate of the Series E Preferred Stock has been fixed at 1% per annum until February 7, 2016. Beginning on February 8, 2016, the dividend rate will be fixed at 9% per annum.

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

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

**12. Accumulated Other Comprehensive Loss**

The following table presents the changes in each component of accumulated other comprehensive loss, net of tax, for the three and nine months ended September 30, 2015 and 2014 (in thousands):

|  | Three months ended<br>September 30, 2015  |           |                      | Three months ended<br>September 30, 2014  |           |                      |
|--|---|-----------|----------------------|---|-----------|----------------------|
|  | Net<br>Unrealized<br>Gains<br>and<br>(Losses)<br>on<br>Investment<br>Securities<br>AFS <sup>(1)</sup> |           | Total <sup>(1)</sup> | Net<br>Unrealized<br>Gains<br>and<br>(Losses)<br>on<br>Investment<br>Securities<br>AFS <sup>(1)</sup> |           | Total <sup>(1)</sup> |
|  | Defined<br>Benefit<br>Pension<br>Items <sup>(1)</sup>   |           |                      | Defined<br>Benefit<br>Pension<br>Items <sup>(1)</sup>   |           |                      |
| Beginning balance  | \$1,429   | \$(7,897) | \$(6,468)            | \$1,950   | \$(6,659) | \$(4,709)            |
| Other comprehensive income (loss) before reclassifications | 256   | 208       | 464                  | (463)   |           | (463)                |
|  | 24  |           | 24                   | 527   |           | 527                  |



Amounts reclassified from accumulated  
other comprehensive loss

|   |         |           |           |         |           |           |
|---|---------|-----------|-----------|---------|-----------|-----------|
| Net current period other comprehensive<br>income (loss) | 280     | 208       | 488       | (463 )  | 527       | 64        |
| Ending balance  | \$1,709 | \$(7,689) | \$(5,980) | \$1,487 | \$(6,132) | \$(4,645) |

(1) Amounts in parentheses indicate debits on the Consolidated Balance Sheets.

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|  | Nine months ended September 30, 2015  |                      |           | Nine months ended September 30, 2014  |                      |           |
|--|---|----------------------|-----------|---|----------------------|-----------|
|  | Net Unrealized Gains and (Losses) on Investment Securities AFS <sup>(1)</sup> |                      |           | Net Unrealized Gains and (Losses) on Investment Securities AFS <sup>(1)</sup> |                      |           |
|  | Defined Benefit Pension Items <sup>(1)</sup>                                  | Total <sup>(1)</sup> |           | Defined Benefit Pension Items <sup>(1)</sup>                                  | Total <sup>(1)</sup> |           |
| Beginning balance  | \$1,843   | \$(8,745)            | \$(6,902) | \$1,043   | \$(6,918)            | \$(5,875) |
| Other comprehensive income (loss) before reclassifications     | (139 )  | 1,056                | 917       | 561   | 259                  | 820       |
| Amounts reclassified from accumulated other comprehensive loss | 5   |                      | 5         | (117 )  | 527                  | 410       |
| Net current period other comprehensive income (loss)           | (134 )  | 1,056                | 922       | 444   | 786                  | 1,230     |
| Ending balance   | \$1,709   | \$(7,689)            | \$(5,980) | \$1,487   | \$(6,132)            | \$(4,645) |

(1) Amounts in parentheses indicate debits on the Consolidated Balance Sheets.

The following table presents the amounts reclassified out of each component of accumulated other comprehensive loss for the three and nine months ended September 30, 2015 and 2014 (in thousands):

| Details about accumulated other comprehensive loss components | Amount reclassified from accumulated other comprehensive loss <sup>(1)</sup> |   | Affected line item in the statement of operations    |
|---|--|---|--|
|   | For the three months ended September 30, 2015                                | For the three months ended September 30, 2014 |  |
| Unrealized gains and losses on sale of securities             | \$ 36  | \$  | Net realized (gains) losses on investment securities |

(12 )

|  |       |    |                          |
|--|-------|----|--------------------------|
|  |       |    | Provision for income tax |
|  |       |    | expense                  |
|  | \$ 24 | \$ | Net of tax               |
| Total reclassifications for the period | \$ 24 | \$ | Net income               |

(1)

Amounts in parentheses indicate credits.

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| Details about accumulated other comprehensive loss components | Amount reclassified from accumulated other comprehensive loss <sup>(1)</sup> | For the nine months ended September 30, 2014 | For the nine months ended September 30, 2015 | Affected line item in the statement of operations    |
|---|--|--|--|--|
| Unrealized gains and losses on sale of securities             | \$ 8   |  | \$ (177)                                     | Net realized (gains) losses on investment securities |
|   |  | (3)  | 60   | Provision for income tax expense                     |
| Amortization of defined benefit items <sup>(2)</sup>          | \$ 5   |  | \$ (117)                                     | Net of tax   |
| Amortization of prior year service cost                       | \$   |  | \$ 5   | Salaries and employee benefits                       |
|   |  |  | (2)  | Provision for income tax expense                     |
|   | \$   |  | \$ 3   | Net of tax   |
| Total reclassifications for the period                        | \$ 5   |  | \$ (114)                                     | Net income   |

(1) Amounts in parentheses indicate credits.

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

**13. Regulatory Capital**

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

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. For September 30, 2015, the final Basel III rules require the Company to maintain minimum amounts and ratios of common equity Tier I capital (as defined in the regulations) to risk-weighted assets (RWA) (as defined). Additionally under Basel III rules, the decision was made to opt-out of including accumulated other comprehensive income in regulatory capital. For December 31, 2014, regulatory capital ratios were calculated under Basel I rules. As of September 30, 2015, the Bank was categorized as Well Capitalized under the regulatory framework for prompt corrective action promulgated by the Federal Reserve. The Company believes that no conditions or events have occurred that would change this conclusion as of such date. To be categorized as Well Capitalized, the Bank must maintain minimum Total Capital, Common Equity Tier 1 Capital, Tier 1 Capital, and Tier 1 leverage ratios as set forth in the table. Additionally, while not a regulatory capital ratio, the Company's tangible common equity ratio was 7.87% at September 30, 2015 (in thousands, except ratios).

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****13. Regulatory Capital (continued)**

At September 30, 2015

|   | Actual     |        | For Capital Adequacy Purposes |       | To Be Well Capitalized Under Prompt Corrective Action Provisions |        |
|---|------------|--------|-------------------------------|-------|--|--------|
|   | Amount     | Ratio  | Amount                        | Ratio | Amount   | Ratio  |
| Total Capital (To RWA)                      |            |        |                               |       |  |        |
| Consolidated                                | \$ 134,591 | 14.77% | \$ 72,904                     | 8.00% | \$ 91,130  | 10.00% |
| AmeriServ Financial Bank                    | 106,582    | 11.81  | 72,178                        | 8.00  | 90,223   | 10.00  |
| Common Equity Tier 1 Capital (To RWA)       |            |        |                               |       |  |        |
| Consolidated                                | 91,825     | 10.08  | 41,009                        | 4.50  | 59,235   | 6.50   |
| AmeriServ Financial Bank                    | 95,906     | 10.63  | 40,600                        | 4.50  | 58,645   | 6.50   |
| Tier 1 Capital (To RWA)                     |            |        |                               |       |  |        |
| Consolidated                                | 123,915    | 13.60  | 54,678                        | 6.00  | 72,904   | 8.00   |
| AmeriServ Financial Bank                    | 95,906     | 10.63  | 54,134                        | 6.00  | 72,178   | 8.00   |
| Tier 1 Capital (To Average Assets) leverage |            |        |                               |       |  |        |
| Consolidated                                | 123,915    | 11.40  | 43,473                        | 4.00  | 54,342   | 5.00   |
| AmeriServ Financial Bank                    | 95,906     | 9.06   | 42,327                        | 4.00  | 52,909   | 5.00   |

At December 31, 2014

|                                    | Actual     |        | For Capital Adequacy Purposes |       | To Be Well Capitalized Under Prompt Corrective Action Provisions |        |
|------------------------------------|------------|--------|-------------------------------|-------|--|--------|
|                                    | Amount     | Ratio  | Amount                        | Ratio | Amount   | Ratio  |
| Total Capital (To RWA)             |            |        |                               |       |  |        |
| Consolidated                       | \$ 131,497 | 14.80% | \$ 71,066                     | 8.00% | \$ 88,833  | 10.00% |
| AmeriServ Financial Bank           | 106,084    | 12.07  | 70,305                        | 8.00  | 87,881   | 10.00  |
| Tier 1 Capital (To RWA)            |            |        |                               |       |  |        |
| Consolidated                       | 120,992    | 13.62  | 35,533                        | 4.00  | 53,300   | 6.00   |
| AmeriServ Financial Bank           | 95,579     | 10.88  | 35,153                        | 4.00  | 52,729   | 6.00   |
| Tier 1 Capital (To Average Assets) |            |        |                               |       |  |        |
| Consolidated                       | 120,992    | 11.34  | 42,662                        | 4.00  | 53,327   | 5.00   |
| AmeriServ Financial Bank           | 95,579     | 9.19   | 41,608                        | 4.00  | 52,010   | 5.00   |

On July 2, 2013, the Board of Governors of the Federal Reserve System approved final rules that substantially amend the regulatory risk-based capital rules applicable to the Company and the Bank. The final rules implement the Basel III regulatory capital reforms, as well as certain changes required by the Dodd-Frank Act, which will require institutions to, among other things, have more capital and a higher quality of capital by increasing the minimum regulatory capital ratios, and requiring capital buffers. The new rules became effective for the Company and the Bank

on January 1, 2015, and have an implementation period that stretches to January 1, 2019. For a more detailed discussion see the Capital Resources section of the MD&A.

## 14. Segment Results

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

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****14. Segment Results (continued)**

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

The contribution of the major business segments to the Consolidated Statements of Operations for the three and nine months ended September 30, 2015 and 2014 were as follows (in thousands):

|                    | Three months ended<br>September 30, 2015 |                         | Nine months ended<br>September 30, 2015 |                         | September<br>30,<br>2015 |
|--------------------|--|-------------------------|---|-------------------------|--------------------------|
|                    | Total<br>revenue                         | Net<br>income<br>(loss) | Total<br>revenue                        | Net<br>income<br>(loss) | Total<br>assets          |
| Retail banking     | \$ 6,501                                 | \$ 723                  | \$ 19,564                               | \$ 2,125                | \$ 376,034               |
| Commercial banking | 4,945                                    | 1,553                   | 14,318                                  | 4,178                   | 599,796                  |
| Trust              | 2,177                                    | 391                     | 6,574                                   | 1,167                   | 5,260                    |
| Investment/Parent  | (573 )                                   | (834 )                  | (2,268 )                                | (2,847 )                | 129,753                  |
| Total              | \$ 13,050                                | \$ 1,833                | \$ 38,188                               | \$ 4,623                | \$ 1,110,843             |

  

|                    | Three months ended<br>September 30, 2014 |                         | Nine months ended<br>September 30, 2014 |                         | December<br>31, 2014 |
|--------------------|--|-------------------------|---|-------------------------|----------------------|
|                    | Total<br>revenue                         | Net<br>income<br>(loss) | Total<br>revenue                        | Net<br>income<br>(loss) | Total<br>assets      |
| Retail banking     | \$ 6,651                                 | \$ 706                  | \$ 19,238                               | \$ 1,671                | \$ 376,009           |
| Commercial banking | 4,279                                    | 1,141                   | 12,691                                  | 3,267                   | 563,690              |
| Trust              | 1,907                                    | (432 )                  | 6,062                                   | 232                     | 5,015                |
| Investment/Parent  | (841 )                                   | (1,050 )                | (1,916 )                                | (2,896 )                | 144,549              |



|       |           |        |           |          |              |
|-------|-----------|--------|-----------|----------|--------------|
| Total | \$ 11,996 | \$ 365 | \$ 36,075 | \$ 2,274 | \$ 1,089,263 |
|-------|-----------|--------|-----------|----------|--------------|

## 15. Commitments and Contingent Liabilities

The Company had various outstanding commitments to extend credit approximating \$193.6 million and \$188.0 million along with standby letters of credit of \$7.6 million and \$7.2 million as of September 30, 2015 and December 31, 2014, respectively. The Company's exposure to credit loss in the event of nonperformance by the other party to these commitments to extend credit and standby letters of credit is represented by their contractual amounts. The Bank uses the same credit and collateral policies in making commitments and conditional obligations as for all other lending.

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

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The Company has a noncontributory defined benefit pension plan covering certain employees who work at least 1,000 hours per year. The participants shall have a vested interest in their accrued benefit after five full years of service. The benefits of the plan are based upon the employee's years of service and average annual earnings for the highest five consecutive calendar years during the final ten year period of employment. Plan assets are primarily debt securities (including US Treasury and Agency securities, corporate notes and bonds), listed common stocks (including shares of AmeriServ Financial, Inc. common stock which is limited to 10% of the plan's assets), mutual funds, and short-term cash equivalent instruments. The net periodic pension cost for the three and nine months ended September 30, 2015 and 2014 were as follows (in thousands):

|   | Three months ended<br>September 30, |        | Nine months ended<br>September 30, |          |
|---|-------------------------------------|--------|------------------------------------|----------|
|   | 2015                                | 2014   | 2015                               | 2014     |
| Components of net periodic benefit cost |                                     |        |                                    |          |
| Service cost                            | \$ 400                              | \$ 430 | \$ 1,200                           | \$ 1,290 |
| Interest cost                           | 325                                 | 331    | 975                                | 993      |
| Expected return on plan assets          | (525 )                              | (498 ) | (1,575 )                           | (1,494 ) |
| Amortization of prior year service cost |                                     | (5 )   |                                    | (15 )    |
| Recognized net actuarial loss           | 300                                 | 272    | 900                                | 816      |
| Net periodic pension cost               | \$ 500                              | \$ 530 | \$ 1,500                           | \$ 1,590 |

The Company implemented a soft freeze of its defined benefit pension plan to provide that non-union employees hired on or after January 1, 2013 and union employees hired on or after January 1, 2014 are not eligible to participate in the pension plan. Instead, such employees are eligible to participate in a qualified 401(k) plan. This change was made to help reduce pension costs in future periods.

**17. Disclosures about Fair Value Measurements**

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

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

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

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

determination of fair value require significant management judgment or estimation.

Assets and Liability Measured on a Recurring Basis

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

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TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****17. Disclosures about Fair Value Measurements (continued)**

The following tables present the assets reported on the Consolidated Balance Sheets at their fair value as of September 30, 2015 and December 31, 2014, by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

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

|                                      | Fair Value Measurements at September 30,<br>2015 Using |           |           |           |
|--------------------------------------|--|-----------|-----------|-----------|
|                                      | Total  | (Level 1) | (Level 2) | (Level 3) |
| US Agency securities                 | \$ 2,900   | \$        | \$ 2,900  | \$        |
| US Agency mortgage-backed securities | 94,342   |           | 94,342    |           |
| Corporate bonds                      | 17,410   |           | 17,410    |           |

|                                      | Fair Value Measurements at December 31,<br>2014 Using |           |           |           |
|--------------------------------------|---|-----------|-----------|-----------|
|                                      | Total   | (Level 1) | (Level 2) | (Level 3) |
| US Agency securities                 | \$ 5,906  | \$        | \$ 5,906  | \$        |
| US Agency mortgage-backed securities | 105,768   |           | 105,768   |           |
| Corporate bonds                      | 15,436  |           | 15,436    |           |

Assets Measured on a Non-recurring Basis

Loans considered impaired are loans for which, based on current information and events, it is probable that the creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. As detailed in the allowance for loan loss footnote, impaired loans are reported at fair value of the underlying collateral if the repayment is expected solely from the collateral. Collateral values are estimated using Level 3 inputs based on observable market data which at times are discounted. At September 30, 2015, impaired loans with a carrying value of \$965,000 were reduced by a specific valuation allowance totaling \$524,000 resulting in a net fair value of \$441,000.

At December 31, 2014, impaired loans with a carrying value of \$989,000 were reduced by a specific valuation allowance totaling \$520,000 million resulting in a net fair value of \$469,000.

Other real estate owned is measured at fair value based on appraisals, less cost to sell at the date of foreclosure.

Valuations are periodically performed by management. Income and expenses from operations and changes in valuation allowance are included in the net expenses from OREO.

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

Fair Value Measurements at September 30,  
2015 Using

|                         | Total  | (Level 1) | (Level 2) | (Level 3) |
|-------------------------|--------|-----------|-----------|-----------|
| Impaired loans          | \$ 441 | \$        | \$        | \$ 441    |
| Other real estate owned | 172    |           |           | 172       |

Fair Value Measurements at December 31,  
2014 Using

|                         | Total  | (Level 1) | (Level 2) | (Level 3) |
|-------------------------|--------|-----------|-----------|-----------|
| Impaired loans          | \$ 469 | \$        | \$        | \$ 469    |
| Other real estate owned | 512    |           |           | 512       |

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TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****17. Disclosures about Fair Value Measurements (continued)**

| September 30, 2015      | Quantitative Information About Level 3 Fair Value Measurements |  |  |                                    |
|-------------------------|--|--|--|------------------------------------|
|                         | Fair Value Estimate  | Valuation Techniques                       | Unobservable Input   | Range (Wgt'd Ave)                  |
| Impaired loans          | \$441  | Appraisal of collateral <sup>(1),(3)</sup> | Appraisal adjustments <sup>(2)</sup><br>Liquidation expenses | 0% to 35% (30%)<br>1% to 15% (10%) |
| Other real estate owned | 172  | Appraisal of collateral <sup>(1),(3)</sup> | Appraisal adjustments <sup>(2)</sup><br>Liquidation expenses | 0% to 48% (38%)<br>1% to 20% (10%) |

| December 31, 2014       | Quantitative Information About Level 3 Fair Value Measurements |  |  |                                    |
|-------------------------|--|--|--|------------------------------------|
|                         | Fair Value Estimate  | Valuation Techniques                       | Unobservable Input   | Range (Wgt'd Ave)                  |
| Impaired loans          | \$469  | Appraisal of collateral <sup>(1),(3)</sup> | Appraisal adjustments <sup>(2)</sup><br>Liquidation expenses | 0% to 37% (30%)<br>1% to 15% (10%) |
| Other real estate owned | 512  | Appraisal of collateral <sup>(1),(3)</sup> | Appraisal adjustments <sup>(2)</sup><br>Liquidation expenses | 47% to 83% (55%)<br>1% to 61% (9%) |

(1) Fair Value is generally determined through independent appraisals of the underlying collateral, which generally include various level 3 inputs which are not identifiable.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions.

(3) Includes qualitative adjustments by management and estimated liquidation expenses.

**DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS**

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

Fair values have been determined by the Company using independent third party valuations that use the best available data (Level 2) and an estimation methodology (Level 3) the Company believes is suitable for each category of financial instruments. Management believes that cash, cash equivalents, and loans and deposits with floating interest rates have estimated fair values which approximate the recorded book balances. The estimation methodologies used, the estimated fair values based on US GAAP measurements, and recorded book balances at September 30, 2015 and December 31, 2014, were as follows (in thousands):

|   | September 30, 2015 |                      |           |           |
|---|--------------------|----------------------|-----------|-----------|
|   | Carrying Value     | Fair Value (Level 1) | (Level 2) | (Level 3) |
| <b>FINANCIAL ASSETS:</b>                                  |                    |                      |           |           |
| Cash and cash equivalents                                 | \$31,748           | \$31,748             | \$31,748  | \$        |
| Investment securities AFS                                 | 114,652            | 114,652              |           | 114,652   |
| Investment securities HTM                                 | 20,361             | 20,771               |           | 17,829    |
| Regulatory stock  | 6,786              | 6,786                | 6,786     |           |
| Loans held for sale                                       | 2,913              | 2,983                | 2,983     |           |
| Loans, net of allowance for loan loss and unearned income | 855,528            | 857,049              |           | 857,049   |
| Accrued interest income receivable                        | 3,315              | 3,315                | 3,315     |           |
| Bank owned life insurance                                 | 37,266             | 37,266               | 37,266    |           |
| <b>FINANCIAL LIABILITIES:</b>                             |                    |                      |           |           |
| Deposits with no stated maturities                        | \$591,286          | \$591,286            | \$591,286 | \$        |
| Deposits with stated maturities                           | 278,613            | 281,283              |           | 281,283   |
| Short-term borrowings                                     | 52,988             | 52,988               | 52,988    |           |
| All other borrowings                                      | 61,085             | 65,142               |           | 65,142    |
| Accrued interest payable                                  | 1,601              | 1,601                | 1,601     |           |

TABLE OF CONTENTS**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****17. Disclosures about Fair Value Measurements (continued)**

|   | December 31, 2014 |            |           |           |           |
|---|-------------------|------------|-----------|-----------|-----------|
|   | Carrying Value    | Fair Value | (Level 1) | (Level 2) | (Level 3) |
| <b>FINANCIAL ASSETS:</b>                                  |                   |            |           |           |           |
| Cash and cash equivalents                                 | \$32,872          | \$32,872   | \$32,872  | \$        | \$        |
| Investment securities AFS                                 | 127,110           | 127,110    |           | 127,110   |           |
| Investment securities HTM                                 | 19,840            | 20,213     |           | 17,241    | 2,972     |
| Regulatory stock  | 6,173             | 6,173      | 6,173     |           |           |
| Loans held for sale                                       | 5,051             | 5,127      | 5,127     |           |           |
| Loans, net of allowance for loan loss and unearned income | 817,457           | 819,935    |           |           | 819,935   |
| Accrued interest income receivable                        | 3,127             | 3,127      | 3,127     |           |           |
| Bank owned life insurance                                 | 37,417            | 37,417     | 37,417    |           |           |
| <b>FINANCIAL LIABILITIES:</b>                             |                   |            |           |           |           |
| Deposits with no stated maturities                        | \$568,625         | \$568,625  | \$568,625 | \$        | \$        |
| Deposits with stated maturities                           | 301,256           | 304,744    |           |           | 304,744   |
| Short-term borrowings                                     | 38,880            | 38,880     | 38,880    |           |           |
| All other borrowings                                      | 55,085            | 59,256     |           |           | 59,256    |
| Accrued interest payable                                  | 1,706             | 1,706      | 1,706     |           |           |

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

The fair value of investment securities is equal to the available quoted market price for similar securities. The fair value measurements consider observable data that may include dealer quoted market spreads, cash flows, the US Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. The Level 3 securities are valued by discounted cash flows using the US Treasury rate for the remaining term of the securities.

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

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

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



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

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

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**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**17. Disclosures about Fair Value Measurements (continued)**

Commitments to extend credit and standby letters of credit are financial instruments generally not subject to sale, and fair values are not readily available. The carrying value, represented by the net deferred fee arising from the unrecognized commitment, and the fair value, determined by discounting the remaining contractual fee over the term of the commitment using fees currently charged to enter into similar agreements with similar credit risk, is not considered material for disclosure. The contractual amounts of unfunded commitments are presented in Note 15.

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

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**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS ( M.D.& A. )**

.....**2015 THIRD QUARTER SUMMARY OVERVIEW**.....AmeriServ Financial, Inc. reported third quarter 2015 net income available to common shareholders of \$1,781,000, or \$0.09 per diluted common share. This represented a significant increase in earnings per share from the third quarter of 2014 where net income available to common shareholders totaled \$312,000, or \$0.02 per diluted common share. The third quarter 2014 performance was negatively impacted by a \$669,000 goodwill impairment charge. For the nine month period ended September 30, 2015, the Company reported net income available to common shareholders of \$4,466,000, or \$0.24 per diluted share. This also represented a 118% increase in earnings per share from the first nine months of 2014 where net income available to common shareholders totaled \$2,116,000, or \$0.11 per diluted common share. Our improved financial performance of 2015 resulted from a disciplined focus on successfully executing our business plan to increase profitability and improve the earnings power of AmeriServ Financial, Inc. We were able to increase revenue and reduce non-interest expense to help achieve meaningful growth in earnings per share. Non-interest income was positively impacted by increased revenue from bank owned life insurance. Additionally, we have shown sustained earnings improvement in 2015 while maintaining excellent asset quality and a strong capital position.

Some of the more significant trends include the following:

The third quarter of 2015 marks the tenth consecutive quarter in which the Company has set a new high in loans outstanding. The net loan growth during these ten consecutive quarters now exceeds \$150 million. During these same ten consecutive quarters, the total of non-performing assets has fallen by \$2,093,000 or 47.7%. This is evidence that AmeriServ continues to maintain the appropriate level of credit standards for a community bank. Management's drive for efficiency resulted in operating expenses in the third quarter of 2015 totaling \$355,000 less than in the third quarter of 2014. This has been a company wide effort and the result has exceeded our expectations. A common measure in the community banking industry is the ratio of non-interest expenses to total revenue. In the third quarter of 2015, this ratio was below 80% at AmeriServ for the first full quarter since 2008. Last year, we reported that 2014 was a record year for the Trust Company. However, after nine months of 2015, this same Trust Company is 27.3% better than the 2014 nine-month level of net income. It is quite positive to be able to list these kinds of results. Progress requires hard work and painstaking execution. This Board and this management team are very aware of this fact and appreciate the contribution of every AmeriServ banker to these results.

The leadership team of AmeriServ has always worked closely with the regulatory authorities in the Department of Banking and Securities in Harrisburg, Pennsylvania and in the Federal Reserve Bank of Philadelphia. We understand their responsibility to maintain a healthy banking industry. However, we also offer our own thoughts and ideas to our regulators so that we remain a part of the dialogue between banker and regulator in a positive atmosphere that is both practical and rewarding.

The Rust Belt economy continues to struggle but that is not a new discovery. The difficult days at AmeriServ are not so long ago and we have learned how to monitor risk throughout this Company. The inclusion of a Chief Risk Officer in our Executive Management Team is giving us all a more precise view of the risks that do exist at AmeriServ. Our business like most businesses is moving faster and our protection is care and thoughtfulness in the monitoring of every known risk.



TABLE OF CONTENTS**THREE MONTHS ENDED SEPTEMBER 30, 2015 VS. THREE MONTHS ENDED SEPTEMBER 30, 2014**

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

|   | Three months ended<br>September 30,<br>2015 |   | Three months ended<br>September 30,<br>2014 |   |
|---|---|---|---|---|
| Net income                                  | \$ 1,833                                    |   | \$ 365                                      |   |
| Net income available to common shareholders | 1,781                                       |   | 312   |   |
| Diluted earnings per share                  | 0.09  |   | 0.02  |   |
| Return on average assets (annualized)       | 0.66  | % | 0.14  | % |
| Return on average equity (annualized)       | 6.15  | % | 1.25  | % |

The Company continued its positive earnings momentum in the third quarter of 2015 by reporting net income available to common shareholders of \$1,781,000, or \$0.09 per diluted common share. This represented a significant increase in earnings per share from the third quarter of 2014 where net income available to common shareholders totaled \$312,000, or \$0.02 per diluted common share. Solid loan growth in our community banking business contributed to an increase of \$632,000, or 7.5%, in net interest income. Non-interest expense in the third quarter of 2015 declined by \$1.0 million, or 9.1%, as we are realizing the savings from several profitability improvement initiatives that were implemented in late 2014. The third quarter 2014 performance was negatively impacted by a \$669,000 goodwill impairment charge. A lower level of professional fees also contributed to the favorable comparison.

**.....NET INTEREST INCOME AND MARGIN.....**The Company's net interest income represents the amount by which interest income on average earning assets exceeds interest paid on average interest bearing liabilities. Net interest income is a primary source of the Company's earnings, and it is affected by interest rate fluctuations as well as changes in the amount and mix of average earning assets and average interest bearing liabilities. The following table compares the Company's net interest income performance for the third quarter of 2015 to the third quarter of 2014 (in thousands, except percentages):

|                     | Three months ended<br>September 30,<br>2015 |   | Three months ended<br>September 30,<br>2014 |   | \$     | %      |
|---------------------|---|---|---|---|--------|--------|
|                     |   |   |   |   | Change | Change |
| Interest income     | \$ 10,667                                   |   | \$ 10,019                                   |   | \$ 648 | 6.5 %  |
| Interest expense    | 1,632                                       |   | 1,616                                       |   | 16     | 1.0    |
| Net interest income | \$ 9,035                                    |   | \$ 8,403                                    |   | \$ 632 | 7.5    |
| Net interest margin | 3.52  | % | 3.42  | % | 0.10   | N/M    |

N/M not meaningful

The Company's net interest income in the third quarter of 2015 increased by \$632,000, or 7.5%, from the prior year's third quarter. The Company has been able to increase its net interest income through a combination of earning asset

growth and improved net interest margin performance. The Company's net interest margin of 3.52% for the third quarter of 2015 was 10 basis points better than the net interest margin of 3.42% for the third quarter of 2014.

Specifically, the earning asset growth has occurred in the loan portfolio as total loans averaged \$859 million in the third quarter of 2015 which is \$50 million, or 6.2%, higher than the \$809 million average for the third quarter of 2014. This loan growth reflects the successful results of the Company's sales calling efforts, with an emphasis on generating commercial loans and owner occupied commercial real estate loans particularly through its loan production offices.

Interest income in 2015 has also benefitted from greater prepayment fees on early loan payoffs and an increased dividend from the FHLB of Pittsburgh. Overall, total interest income has increased by \$648,000, or 6.5%, in the third quarter of 2015.

Total interest expense has been well controlled in 2015 as it increased by only \$16,000 in the third quarter of 2015 as compared to the same period in 2014 due to tight control of our cost of funds through disciplined deposit pricing. Even with this reduction in deposit costs, the Company continues to have a strong loyal core deposit base and success in cross-selling new loan customers into deposit products. Specifically, total deposits were relatively stable and averaged \$875 million for the third quarter of 2015 which is only

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\$2.1 million, or 0.2%, lower than the \$877 million average for the same period in 2014. This slight decrease in total deposits occurred primarily in a few rate sensitive accounts and is indicative of the competitive pressures that all community banks must deal with to retain customer accounts in this low interest rate environment. Alternatively, the Company is pleased that, within the mix of total deposits, a meaningful portion of deposit growth occurred in non-interest bearing demand deposit accounts. The decreased interest expense for deposits has been offset by a \$79,000 increase in the interest cost for borrowings as the Company has utilized more FHLB term advances to extend borrowings and provide protection against rising interest rates.

The table that follows provides an analysis of net interest income on a tax-equivalent basis for the three month periods ended September 30, 2015 and September 30, 2014 setting forth (i) average assets, liabilities, and stockholders' equity, (ii) interest income earned on interest earning assets and interest expense paid on interest bearing liabilities, (iii) average yields earned on interest earning assets and average rates paid on interest bearing liabilities, (iv) the Company's interest rate spread (the difference between the average yield earned on interest earning assets and the average rate paid on interest bearing liabilities), and (v) the Company's net interest margin (net interest income as a percentage of average total interest earning assets). For purposes of these tables, loan balances do include non-accrual loans, and interest income on loans includes loan fees or amortization of such fees which have been deferred, as well as interest recorded on certain non-accrual loans as cash is received. Additionally, a tax rate of 34% is used to compute tax-equivalent yields.

**Three months ended September 30** (In thousands, except percentages)

|   | 2015            |                         |            | 2014            |                         |            |
|---|-----------------|-------------------------|------------|-----------------|-------------------------|------------|
|   | Average Balance | Interest Income/Expense | Yield/Rate | Average Balance | Interest Income/Expense | Yield/Rate |
| Interest earning assets:                              |                 |                         |            |                 |                         |            |
| Loans and loans held for sale, net of unearned income | \$858,752       | \$9,727                 | 4.46%      | \$808,731       | \$9,025                 | 4.40%      |
| Interest bearing deposits                             | 1,235           | 1                       | 0.39       | 1,449           | 2                       | 0.66       |
| Short-term investment in money market funds           | 9,496           | 3                       | 0.11       | 7,207           | 1                       | 0.03       |
| Investment securities AFS                             | 124,294         | 790                     | 2.54       | 136,172         | 859                     | 2.53       |
| Investment securities HTM                             | 20,664          | 155                     | 3.00       | 19,644          | 138                     | 2.81       |
| Total investment securities                           | 144,958         | 945                     | 2.61       | 155,816         | 997                     | 2.56       |
| Total interest earning assets/interest income         | 1,014,441       | 10,676                  | 4.16       | 973,203         | 10,025                  | 4.08       |
| Non-interest earning assets:                          |                 |                         |            |                 |                         |            |
| Cash and due from banks                               | 16,362          |                         |            | 16,027          |                         |            |
| Premises and equipment                                | 12,508          |                         |            | 13,477          |                         |            |
| Other assets  | 69,021          |                         |            | 69,528          |                         |            |
| Allowance for loan losses                             | (9,837 )        |                         |            | (10,040 )       |                         |            |
| TOTAL ASSETS  | \$1,102,495     |                         |            | \$1,062,195     |                         |            |
| Interest bearing liabilities:                         |                 |                         |            |                 |                         |            |
| Interest bearing deposits:                            |                 |                         |            |                 |                         |            |
| Interest bearing demand                               | \$101,494       | \$55                    | 0.21%      | \$104,197       | \$52                    | 0.20%      |
| Savings   | 95,968          | 40                      | 0.17       | 89,522          | 36                      | 0.16       |
| Money markets   | 235,578         | 194                     | 0.33       | 228,353         | 196                     | 0.34       |

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|   |         |       |      |         |       |      |
|---|---------|-------|------|---------|-------|------|
| Time deposits   | 277,680 | 885   | 1.26 | 299,730 | 953   | 1.26 |
| Total interest bearing deposits                               | 710,720 | 1,174 | 0.66 | 721,802 | 1,237 | 0.69 |
| Short-term borrowings   | 40,427  | 37    | 0.36 | 12,933  | 10    | 0.27 |
| Advances from Federal Home Loan Bank                          | 46,386  | 141   | 1.20 | 34,729  | 89    | 0.97 |
| Guaranteed junior subordinated deferrable interest debentures | 13,085  | 280   | 8.57 | 13,085  | 280   | 8.57 |
| Total interest bearing liabilities/interest expense           | 810,618 | 1,632 | 0.80 | 782,549 | 1,616 | 0.82 |

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|   | 2015               |                                | 2014       |                                |
|---|--------------------|--------------------------------|------------|--------------------------------|
|   | Average<br>Balance | Interest<br>Income/<br>Expense | Yield/Rate | Average<br>Balance             |
|   |                    |                                |            | Interest<br>Income/<br>Expense |
| Non-interest bearing liabilities:                     |                    |                                |            |                                |
| Demand deposits                                       | 164,092            |                                |            | 155,157                        |
| Other liabilities                                     | 9,531              |                                |            | 8,143                          |
| Shareholders' equity                                  | 118,254            |                                |            | 116,346                        |
| <b>TOTAL LIABILITIES AND<br/>SHAREHOLDERS' EQUITY</b> | <b>\$1,102,495</b> |                                |            | <b>\$1,062,195</b>             |
| Interest rate spread                                  |                    |                                | 3.36       | 3.26                           |
| Net interest income/Net interest<br>margin            |                    | 9,044                          | 3.52 %     | 8,409                          |
| Tax-equivalent adjustment                             |                    | (9 )                           |            | (6 )                           |
| Net Interest Income                                   |                    | \$9,035                        |            | \$8,403                        |

**.....PROVISION FOR LOAN LOSSES.....**The Company recorded a \$300,000 provision for loan losses in the third quarter of 2015 compared to no provision for loan losses in the third quarter of 2014. This provision in the third quarter of 2015 was needed to support the continuing growth of the loan portfolio and cover net loan charge-offs. The Company experienced net loan charge-offs of \$245,000, or 0.11% of total loans, in the third quarter of 2015 compared to net loan charge-offs of \$568,000, or 0.28% of total loans, in the third quarter of 2014. At September 30, 2015, non-performing assets totaled \$2.3 million, or only 0.27% of total loans, and is \$1.6 million lower than the September 30, 2014 level. When determining the provision for loan losses, the Company considers a number of factors, some of which include periodic credit reviews, non-performing assets, loan delinquency and charge-off trends, concentrations of credit, loan volume trends and broader local and national economic trends.

**.....NON-INTEREST INCOME.....**Non-interest income for the third quarter of 2015 totaled \$4.0 million and increased \$422,000, or 11.7%, from the third quarter 2014 performance. Factors contributing to this higher level of non-interest income for the quarter included:

- \* a \$496,000 increase in revenue from bank owned life insurance due to the receipt of two death claims in the quarter; a \$278,000, or 15.4%, increase in trust and investment advisory fees due to increased assets under management
- \* which reflects successful new business development activities as well as effective management of existing customer accounts in this volatile market environment;
- \* a \$103,000, or 54.2%, decrease in mortgage related fees and a \$97,000 decrease in net gains on sale of loans due to reduced volume of refinance activity in 2015;
- \* a \$66,000 decrease in deposit service charges due to fewer overdraft fees during the quarter; and
- \* a \$36,000 loss realized on the sale of investment securities in the third quarter of 2015; The Company had no sales of investment securities in the third quarter of 2014.

**.....NON-INTEREST EXPENSE.....**Non-interest expense for the third quarter of 2015 totaled \$10.2 million and decreased by \$1.0 million, or 9.1%, from the prior year's third quarter. Factors contributing to the lower non-interest expense in the quarter included:

- \* a \$669,000 decrease in goodwill impairment charges as the Company recognized this charge in the third quarter of 2014, with no such charge taken in 2015;
- \* a \$154,000 decrease in professional fees due to lower legal fees, consulting fees and recruitment costs in the third quarter of 2015; and
- \*

a \$60,000, or 1.0%, decrease in salaries and employee benefits due to 23 fewer full time equivalent employees as certain employees who elected to participate in an early retirement program in late 2014 were not replaced in order to achieve efficiencies identified as part of a profitability improvement program.

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

|   | Nine months ended September 30, 2015 |   | Nine months ended September 30, 2014 |   |
|---|--------------------------------------|---|--------------------------------------|---|
| Net income                                  | \$ 4,623                             |   | \$ 2,274                             |   |
| Net income available to common shareholders | 4,466                                |   | 2,116                                |   |
| Diluted earnings per share                  | 0.24                                 |   | 0.11                                 |   |
| Return on average assets (annualized)       | 0.56                                 | % | 0.29                                 | % |
| Return on average equity (annualized)       | 5.29                                 | % | 2.64                                 | % |

The Company reported net income available to common shareholders of \$4,466,000, or \$0.24 per diluted share in the first nine months of 2015. This represented a 118% increase in earnings per share from the first nine months of 2014 where net income available to common shareholders totaled \$2,116,000, or \$0.11 per diluted common share. Solid loan growth as well as cost of funds control through disciplined deposit pricing in our community banking business contributed to an increase of \$1.5 million, or 5.8%, in net interest income. Non-interest income increased due largely to greater revenue from our trust and wealth management business and bank owned life insurance income. Non-interest expense in the first nine months of 2015 declined by \$1.7 million, or 5.3%, due to savings from several profitability improvement initiatives that were implemented in late 2014 and a lower level of professional fees.

.....**NET INTEREST INCOME AND MARGIN**..... The following table compares the Company's net interest income performance for the first nine months of 2015 to the first nine months of 2014 (in thousands, except percentages):

|                     | Nine months ended September 30, 2015 |   | Nine months ended September 30, 2014 |   | \$       | %      |
|---------------------|--------------------------------------|---|--------------------------------------|---|----------|--------|
|                     |                                      |   |                                      |   | Change   | Change |
| Interest income     | \$ 31,599                            |   | \$ 30,097                            |   | \$ 1,502 | 5.0 %  |
| Interest expense    | 4,830                                |   | 4,785                                |   | 45       | 0.9    |
| Net interest income | \$ 26,769                            |   | \$ 25,312                            |   | \$ 1,457 | 5.8    |
| Net interest margin | 3.52                                 | % | 3.48                                 | % | 0.04     | N/M    |

N/M not meaningful

The Company's net interest income for the first nine months of 2015 increased by \$1,457,000, or 5.8%, when compared to the first nine months of 2014. The Company has been able to increase its net interest income through a combination of earning asset growth and improved net interest margin performance. The Company's net interest margin of 3.52% for the first nine months of 2015 was four basis points better than the net interest margin of 3.48% for the first nine months of 2014. Specifically, the earning asset growth has occurred in the loan portfolio as total loans averaged \$853 million in the first nine months of 2015 which is \$55 million, or 7.0%, higher than the \$797 million average for the first nine months of 2014. This loan growth reflects the successful results of the Company's

sales calling efforts, with an emphasis on generating commercial loans and owner occupied commercial real estate loans particularly through its loan production offices in stronger growth markets of Pittsburgh and Altoona in Pennsylvania, and Hagerstown, Maryland. Interest income in 2015 has also benefitted from greater prepayment fees on early loan payoffs and an increased dividend from the FHLB of Pittsburgh. Overall, total interest income has increased by \$1.5 million, or 5.0%, in the first nine months of 2015.

Total interest expense has been well controlled in 2015 as it increased by only \$45,000, or 0.9% in the first nine months of 2015 as compared to the same period in 2014 due to tight control of our cost of funds through disciplined deposit pricing. Total deposit interest expense decreased by \$169,000, or 4.6%, in the first nine months of 2015 from the same timeframe in 2014. Even with this reduction in deposit costs, the Company continues to have a strong loyal core deposit base and success in cross-selling new loan customers into deposit products. Specifically, total deposits averaged \$887 million for the first nine months of 2015 which is \$17 million, or 2.0%, higher than the \$870 million average for the same period in 2014. The

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Company is pleased that a meaningful portion of this deposit growth occurred in non-interest bearing demand deposit accounts. This decreased interest expense for deposits has been offset by a \$214,000 increase in the interest cost for borrowings as the Company has utilized more FHLB term advances to extend borrowings and provide protection against rising interest rates.

The table that follows provides an analysis of net interest income on a tax-equivalent basis for the nine month periods ended September 30, 2015 and September 30, 2014. For a detailed discussion of the components and assumptions included in the table, see the paragraph before the quarterly table on page 31.

**Nine months ended September 30** (In thousands, except percentages)

|   | 2015               |                                |            | 2014               |                                |            |
|---|--------------------|--------------------------------|------------|--------------------|--------------------------------|------------|
|   | Average<br>Balance | Interest<br>Income/<br>Expense | Yield/Rate | Average<br>Balance | Interest<br>Income/<br>Expense | Yield/Rate |
| Interest earning assets:                                      |                    |                                |            |                    |                                |            |
| Loans and loans held for sale, net of unearned income         | \$852,553          | \$28,674                       | 4.45 %     | \$797,090          | \$27,008                       | 4.49 %     |
| Interest bearing deposits                                     | 1,235              | 4                              | 0.40       | 2,635              | 6                              | 0.21       |
| Short-term investment in money market funds                   | 10,228             | 10                             | 0.14       | 6,904              | 3                              | 0.06       |
| Investment securities AFS                                     | 125,967            | 2,480                          | 2.63       | 139,548            | 2,688                          | 2.57       |
| Investment securities HTM                                     | 20,381             | 451                            | 2.95       | 19,103             | 410                            | 2.86       |
| Total investment securities                                   | 146,348            | 2,931                          | 2.67       | 158,651            | 3,098                          | 2.60       |
| Total interest earning assets/interest income                 | 1,010,364          | 31,619                         | 4.16       | 965,280            | 30,115                         | 4.15       |
| Non-interest earning assets:                                  |                    |                                |            |                    |                                |            |
| Cash and due from banks                                       | 17,241             |                                |            | 15,755             |                                |            |
| Premises and equipment  | 12,729             |                                |            | 13,273             |                                |            |
| Other assets  | 69,732             |                                |            | 69,635             |                                |            |
| Allowance for loan losses                                     | (9,751 )           |                                |            | (10,101 )          |                                |            |
| TOTAL ASSETS  | \$1,100,315        |                                |            | \$1,053,842        |                                |            |
| Interest bearing liabilities:                                 |                    |                                |            |                    |                                |            |
| Interest bearing deposits:                                    |                    |                                |            |                    |                                |            |
| Interest bearing demand                                       | \$98,668           | \$151                          | 0.20 %     | \$95,688           | \$140                          | 0.20 %     |
| Savings   | 95,050             | 117                            | 0.16       | 89,647             | 107                            | 0.16       |
| Money markets   | 233,311            | 556                            | 0.32       | 228,898            | 584                            | 0.34       |
| Time deposits   | 291,668            | 2,695                          | 1.24       | 301,959            | 2,857                          | 1.27       |
| Total interest bearing deposits                               | 718,697            | 3,519                          | 0.65       | 716,192            | 3,688                          | 0.69       |
| Short-term borrowings   | 27,228             | 70                             | 0.34       | 16,606             | 34                             | 0.26       |
| Advances from Federal Home Loan Bank                          | 45,300             | 401                            | 1.18       | 30,605             | 223                            | 0.97       |
| Guaranteed junior subordinated deferrable interest debentures | 13,085             | 840                            | 8.57       | 13,085             | 840                            | 8.57       |
| Total interest bearing liabilities/interest expense           | 804,310            | 4,830                          | 0.80       | 776,488            | 4,785                          | 0.82       |
| Non-interest bearing liabilities:                             |                    |                                |            |                    |                                |            |

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|   |                    |       |                    |       |
|---|--------------------|-------|--------------------|-------|
| Demand deposits                                       | 168,634            |       | 153,648            |       |
| Other liabilities                                     | 10,442             |       | 8,395              |       |
| Shareholders' equity                                  | 116,929            |       | 115,311            |       |
| <b>TOTAL LIABILITIES AND<br/>SHAREHOLDERS' EQUITY</b> | <b>\$1,100,315</b> |       | <b>\$1,053,842</b> |       |
| Interest rate spread                                  |                    | 3.36  |                    | 3.33  |
| Net interest income/Net interest<br>margin            | 26,789             | 3.52% | 25,330             | 3.48% |
| Tax-equivalent adjustment                             | (20 )              |       | (18 )              |       |
| Net Interest Income                                   | \$26,769           |       | \$25,312           |       |

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**.....PROVISION FOR LOAN LOSSES.....**The Company recorded a \$750,000 provision for loan losses compared to no provision for loan losses in the first nine months of 2014. The provision recorded in 2015 was needed to support the continuing growth of the loan portfolio and cover net loan charge-offs. The Company experienced net loan charge-offs \$601,000, or 0.09%, of total loans in 2015 compared to net loan charge-offs of \$522,000 or 0.09% of total loans in 2014. Overall, the Company continued to maintain outstanding asset quality during the first nine months of 2015. At September 30, 2015, non-performing assets totaled \$2.3 million, or only 0.27% of total loans, and is \$1.6 million lower than the September 30, 2014 level. In summary, the allowance for loan losses provided a strong 461% coverage of non-performing loans, and 1.13% of total loans, at September 30, 2015, compared to 400% coverage of non-performing loans, and 1.16% of total loans, at December 31, 2014.

**.....NON-INTEREST INCOME.....**Non-interest income for the first nine months of 2015 totaled \$11.4 million and increased \$656,000, or 6.1%, from the first nine months 2014 performance. Factors contributing to this higher level of non-interest income for the period included:

- \* a \$659,000 increase in revenue from bank owned life insurance due to the receipt of a total of three death claims in the first nine months of 2015;
- a \$489,000, or 8.4%, increase in trust and investment advisory fees due to increased assets under management which
- \* reflects successful new business development activities as well as effective management of existing customer accounts in this volatile market environment;
- \* a \$197,000 decrease in deposit service charges due to fewer overdraft fees and account analysis fees during the first nine months of 2015 as customers have modified their behavior by holding greater deposit balances;
- a net \$185,000 reduction in investment security transactions as the Company recognized a modest loss on the sale of
- \* lower yielding securities in the third quarter of 2015 compared to gains realized on the sale of rapidly pre-paying mortgage backed securities in 2014; and
- \* a \$156,000, or 33.4%, decrease in mortgage related fees due to reduced volume of refinance activity in 2015.

**.....NON-INTEREST EXPENSE.....**Non-interest expense for the first nine months of 2015 totaled \$30.9 million and decreased by \$1.7 million, or 5.3%, from the prior year's first nine months. Factors contributing to the lower non-interest expense in 2015 included:

- \* a \$669,000 decrease in goodwill impairment charges as we recognized this charge in 2014 with no such charge taken in 2015;
- a \$464,000, or 2.5%, decrease in salaries and employee benefits due to 23 fewer full time equivalent employees as
- \* certain employees who elected to participate in an early retirement program in late 2014 were not replaced in order to achieve efficiencies identified as part of a profitability improvement program; and
- \* a \$440,000 decrease in professional fees due to lower legal fees, director's fees and recruitment costs in the first nine months of 2015.

The remainder of the key non-interest expense categories were relatively consistent between years reflecting the Company's focus on reducing and controlling costs.

**.....INCOME TAX EXPENSE.....**The Company recorded an income tax expense of \$1,947,000, or an effective tax rate of 29.6%, in the first nine months of 2015 compared to the income tax expense of \$1,200,000, or an effective tax rate of 34.5%, for the first nine months of 2014. The higher income tax expense is due to the Company's increased earnings in the first nine months of 2015 as the Company's effective tax rate is lower than 2014 due to an increase in tax free revenue from bank owned life insurance. The higher effective tax rate in 2014 was also due to the non-deductibility of the goodwill impairment charge for tax purposes.





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.....**SEGMENT RESULTS**.....Retail banking's net income contribution was \$723,000 in the third quarter and \$2.1 million for the first nine months of 2015 which was up by \$17,000 and \$454,000 from the net income contribution for the same 2014 periods, respectively. These increases in earnings in 2015 were due to the higher level of BOLI income, which more than offset a lower level of deposit service charges, residential mortgage related fee income and the higher loan loss provision. In addition, this segments' net interest income benefited from higher consumer loan balances and reduced non-interest expenses particularly personnel costs.

The commercial banking segment reported net income contributions of \$1.6 million in the third quarter and \$4.2 million for the first nine months of 2015 which was \$412,000 and \$911,000 better than the 2014 results for the same periods, respectively. This improved net income contribution was due to higher net interest income as a result of the previously discussed strong growth in commercial and commercial real estate loans over the past year as well as the higher receipt of loan prepayment fee income on early loan payoffs. This growth in net interest income more than offset an increased loan loss provision. Additionally, total non-interest expense was also lower due to cost savings achieved from the profitability improvement program implemented last year.

The trust segment reported net income of \$391,000 in the third quarter and \$1.2 million for the first nine months of 2015 which was \$823,000 and \$935,000 better than the 2014 results for the same periods, respectively. The goodwill impairment charge of \$669,000 was recorded in 2014 at WCCA is included in this segment and was the largest cause of the variance. Both trust fee income and financial services income improved due to increased assets under management which reflects successful new business development activities, as well as market forces and effective management of customer accounts.

The investment/parent segment reported net loss of \$834,000 in the third quarter and \$2.8 million for the first nine months of 2015 which was an improvement of \$216,000 and \$49,000 from the 2014 results for the same periods, respectively. The improvement between years reflects the benefit of receipt of a death claim benefit on a former chairman. However, overall this segment has felt the most earnings pressure from the continued low interest rate environment.

.....**BALANCE SHEET**.....The Company's total consolidated assets were \$1.111 billion at September 30, 2015, which grew by \$21.6 million, or 2.0%, from the December 31, 2014 asset level. The growth in assets was due to a \$38.2 million, or 4.6%, increase in net loans during the first nine months of 2015. This loan increase was partially offset by an \$11.9 million decrease in investment securities as the Company utilized cash flow from the securities portfolio to help fund the loan growth.

Total deposits remained unchanged increasing by a modest \$18,000 in the first nine months of 2015. Total FHLB borrowings have increased by \$20.1 million since year-end 2014. The FHLB term advances with maturities between three and five years grew by \$6 million and now total \$48 million as the Company has utilized these advances to help manage interest rate risk and favorably position our balance sheet in a rising rate environment. The Company's total shareholders' equity increased by \$5.0 million over the first nine months of 2015 due to the Company's net retention of earnings after dividend payments and a reduction in accumulated other comprehensive loss. The Company continues to be considered well capitalized for regulatory purposes with a total capital ratio of 14.77%, and a common equity tier 1 capital ratio of 10.08% at September 30, 2015. (See the discussion of the new Basel III capital requirements under the Capital Resources section.) The Company's book value per common share was \$5.21, its tangible book value per common share was \$4.58, and its tangible common equity to tangible assets ratio was 7.87% at September 30, 2015.



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

|  | September<br>30,<br>2015 | December<br>31,<br>2014 | September<br>30,<br>2014 |
|--|--------------------------|-------------------------|--------------------------|
| Total accruing loan delinquency (past due 30 to 89 days)   | \$ 3,428                 | \$ 2,643                | \$ 2,256                 |
| Total non-accrual loans  | 1,810                    | 2,195                   | 3,001                    |
| Total non-performing assets including TDR*   | 2,294                    | 2,917                   | 3,898                    |
| Accruing loan delinquency, as a percentage of total loans, net of unearned income                          | 0.40 %                   | 0.32 %                  | 0.28 %                   |
| Non-accrual loans, as a percentage of total loans, net of unearned income                                  | 0.21                     | 0.27                    | 0.37                     |
| Non-performing assets, as a percentage of total loans, net of unearned income, and other real estate owned | 0.27                     | 0.35                    | 0.48                     |
| Non-performing assets as a percentage of total assets  | 0.21                     | 0.27                    | 0.36                     |
| As a percent of average loans, net of unearned income:   |                          |                         |                          |
| Annualized net charge-offs   | 0.09                     | 0.11                    | 0.09                     |
| Annualized provision for loan losses   | 0.12                     | 0.05                    |                          |
| Total classified loans (loans rated substandard or doubtful)   | \$ 6,088                 | \$ 11,229               | \$ 12,053                |

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

The Company continued to maintain strong asset quality in the first nine months of 2015 as evidenced by low levels of non-accrual loans, non-performing assets, classified loans, and loan delinquency levels that continue to be well below 1% of total loans. We continue to closely monitor the loan portfolio given the slow recovery in the economy and the number of relatively large-sized commercial and commercial real estate loans within the portfolio. As of September 30, 2015, the 25 largest credits represented 25.3% of total loans outstanding.

.....**ALLOWANCE FOR LOAN LOSSES**.....The following table sets forth the allowance for loan losses and certain ratios for the periods ended (in thousands, except percentages):

|  | September<br>30,<br>2015 | December<br>31,<br>2014 | September<br>30,<br>2014 |
|--|--------------------------|-------------------------|--------------------------|
| Allowance for loan losses  | \$ 9,772                 | \$ 9,623                | \$ 9,582                 |
| Allowance for loan losses as a percentage of each of the following total loans, net of unearned income | 1.13 %                   | 1.16 %                  | 1.18 %                   |
| total accruing delinquent loans (past due 30 to 89 days)   | 285.06                   | 364.09                  | 424.73                   |
| total non-accrual loans  | 539.89                   | 438.21                  | 298.13                   |
| total non-performing assets  | 425.98                   | 329.89                  | 245.82                   |

The Company recorded a \$300,000 loan loss provision in the third quarter and \$750,000 in the first nine months of 2015 and had recorded no loan loss provision for the allowance for loan losses from earnings during the same periods in 2014. The provision recorded in 2015 was needed to support the continuing growth of the loan portfolio and cover net loan charge-offs. As a result, the balance in the allowance for loan losses has increased modestly in the first nine

months of 2015 while the Company has been able to still maintain strong coverage of non-accrual loans and non-performing assets as indicated in the above table.

.....**LIQUIDITY**.....The Company's liquidity position has been strong during the last several years. Our core retail deposit base has grown over the past five years and has been more than adequate to fund the Company's operations. Cash flow from maturities, prepayments and amortization of securities was also used to help fund

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loan growth over the past few years. We strive to operate our loan to deposit ratio in a range of 85% to 100%. For the first nine months of 2015, the Company's loan to deposit ratio has averaged 96.1%. We are optimistic that we can increase the loan to deposit ratio in the future given current commercial loan pipelines, continued growth of our loan production offices and our focus on small business lending.

Liquidity can be analyzed by utilizing the Consolidated Statement of Cash Flows. Cash and cash equivalents decreased by \$1.1 million from December 31, 2014 to September 30, 2015, due to \$27.0 million of cash used in investing activities. This more than offset the \$6.6 million of cash provided by operating activities and \$19.3 million of cash provided by financing activities. Within investing activities, cash provided from investment security maturities was \$23.3 million. Cash advanced for new loan fundings and purchases (excluding residential mortgages sold in the secondary market) totaled \$197.4 million and was \$38.8 million higher than the \$158.6 million of cash received from loan principal payments and participations. Within financing activities, deposits declined by \$56,000 of cash. Total borrowings increased as advances of short-term borrowings and purchases of FHLB term advances grew by \$20.1 million. At September 30, 2015, the Company had immediately available \$348 million of overnight borrowing capacity at the FHLB and \$39 million of unsecured federal funds lines with correspondent banks.

The holding company had \$20.7 million of cash, short-term investments, and investment securities at September 30, 2015. Additionally, dividend payments from our subsidiaries can also provide ongoing cash to the holding company. At September 30, 2015, our subsidiary Bank had \$3.6 million of cash available for immediate dividends to the holding company under applicable regulatory formulas. Overall, we believe that the holding company has strong liquidity to meet its trust preferred debt service requirements, its current preferred stock dividends, and its current common stock dividends, all of which should approximate \$2.1 million over the next twelve months. The most recent \$0.01 dividend was announced on October 20, 2015 payable on November 16, 2015 to shareholders of record on November 2, 2015.

**.....CAPITAL RESOURCES.....**The Bank meaningfully exceeds all regulatory capital ratios for each of the periods presented and is considered well capitalized. The Company's common equity tier 1 ratio was 10.08%, the tier 1 capital ratio was 13.60%, and the total capital ratio was 14.77% at September 30, 2015. The Company's tier 1 leverage was 11.40% at September 30, 2015. We anticipate that we will maintain our strong capital ratios throughout the remainder of 2015. We expect that capital generated from earnings will be utilized to pay the SBLF preferred dividend, common stock cash dividend and will also support anticipated balance sheet growth. Additionally, we plan to retain excess cash to position the Company to redeem all or a portion of the SBLF Preferred Stock when the rate increases from 1% to 9% in the first quarter of 2016. We will also be pursuing a subordinated debt offering in the fourth quarter of 2015 in order to provide funds to assist with the SBLF Preferred Stock redemption. Our common dividend payout ratio for the first nine months of 2015 was 12.5%.

On January 1, 2015, U.S. federal banking agencies implemented the new Basel III capital standards, which, similar to the previous standards, establish the minimum capital levels to be considered well-capitalized and revise the prompt corrective action requirements under banking regulations. The revisions from the previous standards include a revised definition of capital, the introduction of a minimum Common Equity Tier 1 capital ratio and changed risk weightings for certain assets. The implementation of the new rules will be phased in over a four year period ending January 1, 2019 with minimum capital requirements becoming increasingly more strict each year of the transition. The new minimum capital requirements for each ratio, both, initially on January 1, 2015 and at the end of the transition on January 1, 2019, are as follows: A common equity tier 1 capital ratio of 4.5% initially and 7.0% at January 1, 2019; a tier 1 capital ratio of 6.0% and 8.50%; a total capital ratio of 8.0% and 10.50%; and a tier 1 leverage ratio of 5.00% and 5.00%. Under the new rules, in order to avoid limitations on capital distributions (including dividend payments and certain discretionary bonus payments to executive officers), a banking organization must hold a capital conservation buffer above its minimum risk-based capital requirements, which increases over the transition period, from 0.625% of total risk weighted assets in 2016 to 2.5% in 2019. The Company continues to be committed to

maintaining strong capital levels that exceed regulatory requirements while also supporting balance sheet growth and providing a return to our shareholders.

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

| Interest Rate Scenario | Variability of<br>Net Interest<br>Income | Change in<br>Market Value of<br>Portfolio Equity |
|------------------------|--|--|
| 200bp increase         | 1.0 %                                    | 7.8 %  |
| 100bp increase         | 0.5                                      | 5.2  |
| 100bp decrease         | (3.2 )                                   | (13.5 )  |

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

**.....OFF BALANCE SHEET ARRANGEMENTS.....**The Company incurs off-balance sheet risks in the normal course of business in order to meet the financing needs of its customers. These risks derive from commitments to extend credit and standby letters of credit. Such commitments and standby letters of credit involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated financial statements. The Company had various outstanding commitments to extend credit approximating \$193.6 million and standby letters of credit of \$7.6 million as of September 30, 2015. The Company's exposure to credit loss in the event of nonperformance by the other party to these commitments to extend credit and standby letters of credit is represented by their contractual amounts. The Company uses the same credit and collateral policies in making commitments and conditional obligations as for all other lending.

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

| ACCOUNT                    | Allowance for Loan Losses |
|----------------------------|---------------------------|
| BALANCE SHEET REFERENCE    | Allowance for loan losses |
| INCOME STATEMENT REFERENCE | Provision for loan losses |
| DESCRIPTION                |                           |

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



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All of these factors may be susceptible to significant change. Also, the allocation of the allowance for credit losses to specific loan pools is based on historical loss trends and management's judgment concerning those trends.

Commercial and commercial real estate loans are the largest category of credits and the most sensitive to changes in assumptions and judgments underlying the determination of the allowance for loan loss. Approximately \$7.1 million, or 73%, of the total allowance for loan losses at September 30, 2015 has been allocated to these two loan categories.

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

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

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

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

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

Goodwill which has an indefinite useful life is tested for impairment at least annually and written down and charged to results of operations only in periods in which the recorded value is more than the estimated fair value.

In 2014, the CEO of WCCA voluntarily left the employment of the company on January 31, 2014. This caused AmeriServ Financial Inc. and WCCA to initiate legal action against the former CEO in February 2014. This litigation

involved alleged violations of the non-solicitation, non-competition, and other provisions included in the former CEO's employment agreement, as well as other statutory and common law claims. The former CEO's departure and the litigation caused disruption within the WCCA customer base during 2014. After an initial period where WCCA experienced client attrition, the customer base stabilized. Management believes that these clients will continue to use WCCA for investment management services in the future since

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this stabilization has been demonstrated for more than one year. The departure of the former CEO and the subsequent loss of a meaningful number of clients caused a reduction in the earnings capacity of WCCA. This was considered a triggering event which suggested from a qualitative standpoint that the fair value of WCCA and its goodwill was below its carrying amount. This necessitated that management perform the impairment test in accordance with ASC 350. The results of the test resulted in WCCA recording a goodwill impairment loss of \$669,000 in the third quarter of 2014 to write the carrying amount of the goodwill down to the estimated fair value. The Company recorded no such charge in 2015.

**ACCOUNT    Income Taxes**  
**BALANCE SHEET REFERENCE    Net deferred tax asset**  
**INCOME STATEMENT REFERENCE    Provision for income tax expense**  
**DESCRIPTION**

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

In relation to recording the provision for income taxes, management must estimate the future tax rates applicable to the reversal of tax differences, make certain assumptions regarding whether tax differences are permanent or temporary and the related timing of the expected reversal. Also, estimates are made as to whether taxable operating income in future periods will be sufficient to fully recognize any gross deferred tax assets. If recovery is not likely, we must increase our provision for taxes by recording a valuation allowance against the deferred tax assets that we estimate will not ultimately be recoverable. Alternatively, we may make estimates about the potential usage of deferred tax assets that decrease our valuation allowances. As of September 30, 2015, we believe that all of the deferred tax assets recorded on our balance sheet will ultimately be recovered and that no valuation allowances were needed.

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

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

Available-for-sale and held-to-maturity securities are reviewed quarterly for possible other-than-temporary impairment. The review includes an analysis of the facts and circumstances of each individual investment such as the severity of loss, the length of time the fair value has been below cost, the expectation for that security's performance, the creditworthiness of the issuer and the Company's intent and ability to hold the security to recovery. A decline in value that is considered to be other-than-temporary is recorded as a loss within non-interest income in the Consolidated Statements of Operations. At September 30, 2015, the unrealized losses in the available-for-sale security portfolio were comprised of securities issued by government agencies or government sponsored agencies and certain

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

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**.....FORWARD LOOKING STATEMENT.....**

THE STRATEGIC FOCUS:

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

**Customer Service** It is the existing and prospective customer that the Company must satisfy. This means good products and fair prices. But it also means quick response time and professional competence. It means speedy problem resolution and a minimizing of bureaucratic frustrations. The Company is training and motivating its staff to meet these standards while providing customers with more banking options that involve leading technologies such as computers, smartphones, and tablets to conduct business.

**Revenue Growth** It is necessary for the Company to focus on growing revenues. This means loan growth, deposit growth and fee growth. It also means close coordination between all customer service areas so as many revenue producing products as possible can be presented to existing and prospective customers. The Company's Strategic Plan contains action plans in each of these areas particularly on increasing loans through several loan production offices. There will be a particular focus on small business commercial lending. An examination of the peer bank database provides ample proof that a well-executed community banking business model can generate a reliable and rewarding revenue stream.

**Expense Rationalization** The Company remains focused on trying to reduce and rationalize expenses. This has not been a program of broad based cuts, but has been targeted so the Company stays strong but spends less. It is critical to be certain that future expenditures are directed to areas that are playing a positive role in the drive to improve revenues. The Company engaged a consulting firm that specializes in the areas of expense rationalization and profit improvement for community banks in 2014. This firm completed a thorough analysis of our business operations and practices. As a result of this project, the firm provided the Company with recommendations to reduce expenses and improve future profitability. Many of their recommendations have been evaluated and already implemented with further study being done on other recommendations scheduled throughout 2015. The Company has already recognized expense savings in excess of \$1 million through the first nine months of 2015, which more than offsets the cost of this project.

This Form 10-Q contains various forward-looking statements and includes assumptions concerning the Company's beliefs, plans, objectives, goals, expectations, anticipations, estimates, intentions, operations, future results, and prospects, including statements that include the words may, could, should, would, believe, expect, anticipate, intend, project, plan or similar expressions. These forward-looking statements are based upon current expectations, and are subject to risk and uncertainties and are applicable only as of the dates of such statements. Forward-looking statements involve risks, uncertainties and assumptions. Although we do not make forward-looking statements unless we believe we have a reasonable basis for doing so, we cannot guarantee their accuracy. You should not put undue reliance on any forward-looking statements. These statements speak only as of the date of this Form 10-Q, even if subsequently made available on our website or otherwise, and we undertake no obligation to update or revise these statements to reflect events or circumstances occurring after the date of this Form 10-Q. In connection with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, the Company provides the following cautionary statement identifying important factors (some of which are beyond the Company's control) which could cause the actual results or events to differ materially from those set forth in or implied by the forward-looking statements and related assumptions.



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

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

**Item 3.....QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK.....**The Company manages market risk, which for the Company is primarily interest rate risk, through its asset liability management process and committee, see further discussion in Interest Rate Sensitivity section of the M.D. & A.

**Item 4.....CONTROLS AND PROCEDURES.....**(a) Evaluation of Disclosure Controls and Procedures. The Company's management carried out an evaluation, under the supervision and with the participation of the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and the operation of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of September 30, 2015, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer along with the Chief Financial Officer concluded that the Company's disclosure controls and procedures as of September 30, 2015, are effective.

(b) Changes in Internal Controls. There have been no changes in AmeriServ Financial Inc.'s internal controls over financial reporting that occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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## **Part II Other Information**

### **Item 1. Legal Proceedings**

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

### **Item 1A. Risk Factors**

Not Applicable

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

None

### **Item 3. Defaults Upon Senior Securities**

None

### **Item 4. Mine Safety Disclosures**

None

### **Item 5. Other Information**

None

### **Item 6. Exhibits**

- Amended and Restated Articles of Incorporation as amended through August 11, 2011
- 3.1 (Incorporated by reference to Exhibit 3.1 to the Registration Statement on Form S-8 (File No. 333-176869) filed on September 16, 2011).
  - 3.2 Bylaws, as amended and restated on December 30, 2014 (Incorporated by reference to Exhibit 3.2 to the Current report on Form 8-K filed on January 2, 2015).
  - 15.1 Report of S.R. Snodgrass, P.C. regarding unaudited interim financial statement information.
  - 15.2 Awareness Letter of S.R. Snodgrass, P.C.
  - 31.1 Certification pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
  - 31.2



Certification pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

101 The following information from AMERISERV FINANCIAL, INC. s Quarterly Report on Form 10-Q for the quarter ended September 30, 2015, formatted in XBRL (eTensible Business Reporting Language): (i) Consolidated Balance Sheets (unaudited), (ii) Consolidated Statements of Operations (unaudited), (iii) Consolidated Statements of Comprehensive Income (unaudited), (iv) Consolidated Statements of Cash Flows (unaudited), and (iv) Notes to the Unaudited Consolidated Financial Statements.

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

AmeriServ Financial, Inc.

Registrant

/s/ Jeffrey A. Stopko

Date: November 6, 2015

Jeffrey A. Stopko

President and Chief Executive Officer

/s/ Michael D. Lynch

Date: November 6, 2015

Michael D. Lynch

Senior Vice President and Chief Financial Officer

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