CNB CORPORATION

ANNUAL REPORT

December 31, 2012 and 2011

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INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Board of Directors
Of CNB Corporation
Cheboygan, Michigan

Report on the Consolidated Financial Statements

We have audited the consolidated balance sheet of CNB Corporation as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income, changes in stockholders' equity and cash flows for the years then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of CNB Corporation and its subsidiaries as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Plante & Moran, PLLC

Plante & Moran, PLLC

March 28, 2013

Praxity MEMBER
GLOBAL ALLIANCE OF INDEPENDENT FIRMS

CNB CORPORATION
CONSOLIDATED BALANCE SHEETS
December 31, 2012 and 2011

	2012	2011
	(In thousands, except share data)	
ASSETS		
Cash and due from banks	$ 4,676	$ 5,446
Interest-bearing deposits with other financial institutions	13,824	10,095
Total cash and cash equivalents	18,500	15,541
Time deposits with other financial institutions	14,150	14,173
Securities available for sale	98,911	79,086
Securities held to maturity	4,507	4,653
Other securities	997	997
Loans held for sale	1,860	1,810
Loans, net of allowance for loan losses of $3,638 in 2012 and $3,339 in 2011	104,885	115,094
Premises and equipment, net	5,180	5,209
Other assets	11,908	13,579
Total assets	$ 260,898	$ 250,142
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 57,615	$ 49,956
Interest-bearing	180,252	177,987
Total deposits	237,867	227,943
Other liabilities	4,315	4,181
Total liabilities	242,182	232,124
SHAREHOLDERS' EQUITY		
Common stock - $2.50 par value; 2,000,000 shares authorized; 1,212,098 shares issued and outstanding in 2012 and 2011	3,030	3,030
Additional paid-in capital	19,499	19,499
Accumulated deficit	(2,435)	(3,830)
Accumulated other comprehensive loss, net of tax	(1,378)	(681)
Total shareholders' equity	18,716	18,018
Total liabilities and shareholders' equity	$ 260,898	$ 250,142

See accompanying notes to consolidated financial statements.

CNB CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
Years ended December 31, 2012 and 2011

	2012	2011
	(In thousands, except per share data)	
INTEREST INCOME		
Loans, including fees	$ 6,995	$ 7,791
Securities:		
Taxable	838	1,015
Tax exempt	323	434
Other interest income	214	222
Total interest income	8,370	9,462
INTEREST EXPENSE ON DEPOSITS	1,083	1,451
NET INTEREST INCOME	7,287	8,011
Provision for loan losses	1,010	3,015
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	6,277	4,996
NONINTEREST INCOME		
Service charges and fees	1,010	1,032
Net realized gains from sales of loans	720	330
Loan servicing fees, net of amortization	1	50
Gain on the sale of other real estate owned	412	63
Gains on the sale of securities	277	-
Other income	475	492
Total noninterest income	2,895	1,967
NONINTEREST EXPENSES		
Salaries and employee benefits	3,401	3,350
Deferred compensation	270	257
Pension	146	122
Hospitalization	554	570
Occupancy	934	989
Legal and professional	650	690
FDIC Premiums	344	394
Net (gain) losses and carrying costs on ORE	(112)	1,824
Securities impairment write-down	-	2,011
Other expenses	1,124	1,152
Total noninterest expense	7,311	11,359
INCOME (LOSS) BEFORE INCOME TAXES	1,861	(4,396)
Income tax expense (benefit)	466	(1,703)
NET INCOME (LOSS)	$ 1,395	$ (2,693)
Basic earnings (loss) per share	$ 1.15	$ (2.22)
Diluted earnings (loss) per share	1.15	(2.22)

See accompanying notes to consolidated financial statements.

CNB CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years ended December 31, 2012 and 2011

	2012	2011
	(In thousands)	
Net income (loss)	$ 1,395	$ (2,693)
Other comprehensive income (loss):		
Net change in unrealized gains (losses) on securities available for sale	(139)	514
Defined benefit pension plan:		
Net gain (loss) during the period	(880)	(410)
Prior service cost recognized during period	3	2
Tax effects	319	(36)
Total	(697)	70
Total comprehensive income (loss)	$ 698	$ (2,623)

See accompanying notes to consolidated financial statements.

CNB CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years ended December 31, 2012 and 2011

	Outstanding Shares	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss), Net of Tax	Total Shareholders' Equity
	(Dollars in thousands, except share data)					
Balance January 1, 2011	1,212,098	3,030	19,499	(1,137)	(751)	20,641
Net loss				(2,693)		(2,693)
Other comprehensive income (loss)						70
Balance December 31, 2011	1,212,098	3,030	19,499	(3,830)	(751)	18,018
Net income				1,395		1,395
Other comprehensive income (loss)						(697)
Balance December 31, 2012	1,212,098	$ 3,030	$ 19,499	$ (2,435)	$ (751)	$ 18,716

See accompanying notes to consolidated financial statements.

CNB CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2012 and 2011

	2012	2011
	(In thousands)	
Cash flows from operating activities		
Net income (loss)	$ 1,395	$ (2,693)
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Depreciation, amortization and accretion, net	610	582
Provision for loan losses	1,010	3,015
Loans originated for sale	(31,634)	(18,172)
Proceeds from sales of loans originated for sale	30,271	16,567
Gain on sales of investment securities	(277)	-
Gain on sales of loans	(720)	(330)
Gain on sales of other real estate owned properties	(412)	(63)
Other real estate owned writedowns	37	1,534
Net losses on impairment of investment securities	-	2,011
Increase (decrease) in deferred tax benefit	718	(304)
(Increase) Decrease in other assets	892	(1,490)
Decrease in other liabilities	(783)	(518)
Total adjustments	(288)	2,832
Net cash provided by operating activities	1,107	139
Cash flows from investing activities		
Proceeds from sales of securities available for sale	14,934	-
Proceeds from maturities of securities available for sale	36,994	32,881
Purchase of securities available for sale	(71,847)	(45,056)
Proceeds from maturities of securities held to maturity	1,796	2,618
Purchase of securities held to maturity	(1,650)	(840)
Proceeds from redemption of other securities	-	2
Proceeds from maturities of time deposits	5,771	4,333
Purchase of time deposits	(5,748)	(8,880)
Net change in portfolio loans	10,952	8,471
Premises and equipment expenditures	(349)	(101)
Proceeds from sales & redemptions of other real estate owned properties	1,075	1,644
Net cash used in investing activities	(8,072)	(4,928)
Cash flows from financing activities		
Net increase (decrease) in deposits	9,924	(2,223)
Net cash provided by (used) in financing activities	9,924	(2,223)
Net change in cash and cash equivalents	2,959	(7,012)
Cash and cash equivalents at beginning of year	15,541	22,553
Cash and cash equivalents at end of year	$ 18,500	$ 15,541
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest	$ 1,088	$ 1,476
Income taxes	-	-
Non-cash transactions:		
Transfer from loans to other real estate owned	57	3,740

See accompanying notes to consolidated financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The consolidated financial statements include CNB Corporation (the "Company") and its wholly-owned subsidiary, Citizens National Bank of Cheboygan. All significant intercompany accounts and transactions are eliminated in consolidation.

Nature of Operations and Concentrations of Credit Risk: The Company is a one-bank holding company which conducts no direct business activities. All business activities are performed by the Bank.

The Bank provides a full range of banking services to individuals, agricultural businesses, commercial businesses and light industries located in its service area. It maintains a diversified loan portfolio, including loans to individuals for home mortgages, automobiles, personal expenditures and loans to business enterprises for current operations and expansion. The Bank offers a variety of deposit accounts, including checking, savings, money market, individual retirement accounts and certificates of deposit.

The principal markets for the Bank's financial services are the Michigan communities in which the Bank is located and the area immediately surrounding these communities. The Bank serves these markets through seven offices located in Cheboygan, Presque Isle and Emmet Counties in northern lower Michigan.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ. The allowance for loan losses, pension obligation, the value of mortgage servicing rights, other real estate owned properties and fair values of financial instruments are particularly subject to change in the near term.

Cash Flow Reporting: Cash and cash equivalents include cash and due from banks, interest-bearing deposits with other financial institutions and federal funds sold. Net cash flows are reported for customer loan and deposit transactions.

Securities: Securities are classified as held to maturity when management has the positive intent and ability to hold them to maturity and carried at amortized cost. Securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with temporary unrealized holding gains and losses reported in shareholders' equity, net of tax. Declines in the fair value of securities below their cost that are other than temporary are reflected as realized losses. In estimating other-than-temporary charges, management considers: (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, and (3) the Company's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value.

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Other securities, which include Federal Reserve Bank stock and Federal Home Loan Bank stock are carried at cost.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs, and an allowance for loan losses. Loans held for sale are reported at the lower of cost or market on an aggregate basis.

Troubled debt restructuring of loans is undertaken to improve the likelihood that the loan will be repaid in full under the modified terms in accordance with a reasonable repayment schedule. All modified loans are evaluated to determine whether the loans should be reported as a Troubled Debt Restructure (TDR). A loan is a TDR when the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower by modifying or renewing a loan that the Company would not otherwise consider. To make this determination, the Company must determine whether (a) the borrower is experiencing financial difficulties and (b) the Company granted the borrower a concession. This determination requires consideration of all of the facts and circumstances surrounding the modification. An overall general decline in the economy or some deterioration in a borrower's financial condition does not automatically mean the borrower is experiencing financial difficulties.

Loan Income: Interest income is earned on the interest method and includes amortization of net deferred loan fees and costs over the loan term. Interest income is not reported when full loan repayment is in doubt, typically when the loan is impaired or payments are past due over 90 days (180 days for residential mortgages).

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

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and decreased by charge-offs less recoveries. Management estimates the allowance balance required considering past loan

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful. The general component covers non-classified loans and is based on historical loss experience adjusted for current factors.

A loan is impaired when full payment under the loan terms is not expected. Impairment is evaluated in total for smaller-balance homogenous loans of similar nature such as residential mortgage, consumer, and credit card loans, and on an individual loan basis for other loans. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

Premises and Equipment: Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the assets' useful lives. For furniture and fixtures the useful life ranges from three to five years while the useful life for buildings is thirty-nine years. These assets are reviewed for impairment when events indicate the carrying amount may not be recoverable. Maintenance and repairs are charged to expense and improvements are capitalized.

Other Real Estate Owned: Real estate properties acquired through, or in lieu of, loan foreclosure are initially recorded at the lower of the loan carrying amount or fair value at acquisition. Any reduction to fair value from the carrying value of the related loan is accounted for as a loan loss. After acquisition, a valuation allowance reduces the reported amount to the lower of the initial amount or fair value less costs to sell. Expenses, gains and losses on disposition, and changes in the valuation allowance are reported as expenses on the statement of operations.

Servicing Rights: Servicing rights represent the allocated value of servicing rights retained on loans sold. Servicing rights are expensed in proportion to, and over the period of, estimated net servicing revenues. Impairment is evaluated based on the fair value of the rights, using groupings of the underlying loans as to interest rates and then, secondarily, as to prepayment characteristics. Any impairment of a grouping is reported as a valuation allowance.

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Company Owned Life Insurance: The Company has purchased life insurance policies on certain directors and executives. Company owned life insurance is recorded at its cash surrender value, or the amount that can be effectively realized at the balance sheet date. At December 31, 2012 and 2011, the cash surrender value of the underlying policies was $4,499,000 and $4,358,000, which is included in other assets on the balance sheet.

Employee Benefits: A defined benefit pension plan covers substantially all employees, with benefits based on years of service and compensation prior to retirement. Contributions to the plan are based on the maximum amount deductible for income tax purposes. The plan was amended to no longer accept new participants as of December 31, 2008. Current participants will receive benefits as originally outlined in the plan. A 401(k) savings and retirement plan has also been established and covers substantially all employees. Contributions to the 401(k) plan are expensed as made.

Stock Compensation: The Company records compensation costs for the fair value of stock based compensation. The stock option plan, created in 1996, ended in May 2006. A new stock option plan has not been adopted and no stock compensation expense was reported in 2011 or 2012.

Income Taxes: Income tax expense is the sum of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax consequences of temporary differences between the carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

Financial Instruments with Off-Balance-Sheet Risk: The Company, in the normal course of business, makes commitments to extend credit which are not reflected in the consolidated financial statements. A summary of these commitments is disclosed in Note 12.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes the net change in unrealized gains (loss) on securities available for sale, and components of the defined benefit pension obligation not yet recognized as components of periodic pension expense, including unrecognized gains or losses, prior service cost, and the unrecognized transition asset. These items are reported in comprehensive income net of tax.

Earnings Per Share: Basic earnings per share is based on net income divided by the weighted average number of shares outstanding during the period. Diluted earnings per share demonstrates the dilutive effect of additional potential shares issuable under stock options. The weighted average number of shares for basic and diluted earnings per share were 1,212,098 in both 2012 and 2011.

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

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

Adoption of New Accounting Standards:
During 2012, the Company adopted new guidance related to the presentation of comprehensive income in the financial statements. Among other changes, the new guidance eliminated the option to only present comprehensive income in the statement of equity. The Company has elected to report comprehensive income in a separate statement of comprehensive income that begins with net income. The change in presentation has been applied retrospectively and the 2011 financial statements have been restated to conform to the new presentation method. Other than the change in presentation of comprehensive income and related disclosures, the new guidance did not have a material effect on the financial statements.

In 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-02, A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring. This update applies to all creditors, both public and non-public, and was introduced to provide clarification surrounding troubled debt restructurings ("TDR"). The primary characteristics that previously caused a restructuring to qualify as a TDR still exist: (1) the restructuring constitutes a concession to the borrower and (2) the borrower is experiencing financial difficulties. The update provides additional details and examples to provide clarity surrounding these items. The update also prohibits the use of the effective interest rate test when determining whether the restructuring constitutes a concession. The update is effective for annual reporting periods ending on or after December 15, 2012 (therefore, December 31, 2012, for the Company). Lastly, the disclosure requirements set forth by ASU 2010-20 regarding troubled debt restructurings, and later deferred by ASU 2011-1 until December 31, 2012 for the Company, are included in Note 3. Other than the additional disclosures, these updates did not have a significant impact on the financial statements.

In 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820) - Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS. This update to Fair Value Measurement (Topic 820) results in common fair value measurement and disclosure requirements in U.S. GAAP and IFRS. The amendments in this

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

update explain how to measure fair value. They do not require additional fair value measurements and are not intended to establish valuation standards or affect valuation practices outside of financial reporting. However, this update does require expanded disclosure related to the nature and significance of inputs that are used in estimating and measuring the fair value of financial instruments. The amendments in this update are to be applied prospectively and are effective for annual reporting periods beginning after December 15, 2011 (therefore, December 31, 2012, for the Company). This update did not have a significant impact on the financial statements. The impact of this update is reflected in Note 13 of the financial statements).

Subsequent Events: The financial statements and related disclosures include evaluation of events up through and including March 28, 2013, which is the date the financial statements were available to be issued.

NOTE 2 – SECURITIES

The year-end fair values and related gross unrealized gains and losses recognized in accumulated other comprehensive loss for securities available for sale, were as follows:

Available for Sale	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
		(In thousands)	
2012			
U.S. Government and agency	$ 55,993	$ 215	$ (18)
Mortgage-backed	9,000	48	(84)
Collateralized mortgage obligations	11,838	150	(48)
State and municipal	20,970	425	(53)
Auction rate securities	1,000	-	-
Preferred shares	110	88	-
	$ 98,911	$ 926	$ (203)
2011			
U.S. Government and agency	$ 52,915	$ 217	$ (22)
Mortgage-backed	15,168	226	(45)
State and municipal	8,914	418	-
Corporate obligations	1,009	10	-
Auction rate securities	1,000	-	-
Preferred shares	80	58	-
	$ 79,086	$ 929	$ (67)

(Continued)

NOTE 2 – SECURITIES (Continued)

The year-end carrying amount, unrecognized gains and losses, and fair value of securities held to maturity were as follows:

Held to Maturity	Carrying Amount	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
		(In thousands)		
2012				
State and municipal	$ 4,507	$ 412	$ -	$ 4,919
2011				
State and municipal	$ 4,653	$ 477	$ (9)	$ 5,121

Management evaluates securities for other-than-temporary impairment ("OTTI") on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. When evaluating investment securities consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, whether the market decline was affected by macroeconomic conditions and whether the Company has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. In analyzing an issuer's financial condition, the Company may consider whether the securities are issued by the federal government or its agencies, or U.S. Government sponsored enterprises, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When OTTI occurs, the amount of the OTTI recognized in earnings depends on whether we intend to sell the security or it is more likely than not we will be required to sell the security before recovery of its amortized cost basis. If we intend to sell or it is more likely than not we will be required to sell the security before recovery of its amortized cost basis, the OTTI shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment. If a security is determined to be other-than-temporarily impaired, but we do not intend to sell the security, only the credit portion of the estimated loss is recognized in earnings, with the other portion of the loss recognized in other comprehensive income.

During 2011, the Company recorded a $2.0 million impairment write-down as the result of an other-than-temporary impairment of bonds held by the Bank. The impaired bonds were issued to the local hospital in 2001 and 2008. The hospital filed bankruptcy in March 1, 2012 creating an other-than-temporary impairment of the bonds. The write-down is an estimate of expected

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NOTE 2 – SECURITIES (Continued)

losses. Actual losses will be determined through the bankruptcy process. These bonds had a remaining carrying value of $339,000 as of December 31, 2011 and 2012. During 2012, the Company sold fifteen investments. Proceeds from the sale were $14.9 million and gains of $277,000 were recorded from the sales. There were no realized losses during 2012. There were no sales of securities during 2011.

Securities with unrealized losses at year end 2012 and 2011, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows (in thousands):

2012	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Government and agency	$ 8,177	$ (18)	$ -	$ -	$ 8,177	$ (18)
Mortgage-backed	2,125	(7)	3,529	(77)	5,654	(84)
Collateralized mortgage obligations	2,041	(48)	-	-	2,041	(48)
State and municipal	9,787	(53)	-	-	9,787	(53)
Total temporarily impaired	$ 22,130	$ (126)	$ 3,529	$ (77)	$ 25,659	$ (203)

2011	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Government and agency	$ 16,377	$ (22)	$ -	$ -	$ 16,377	$ (22)
Mortgage-backed	3,561	(5)	3,159	(40)	6,720	(45)
State and municipal	805	(9)	-	-	805	(9)
Total temporarily impaired	$ 20,743	$ (36)	$ 3,159	$ (40)	$ 23,902	$ (76)

In 2012, there were 30 securities with unrealized losses and in 2011 there were 14 securities. These unrealized losses remaining on the balance sheet at year end 2012 and 2011 have not been recognized into income because they are not considered to be other-than-temporary. Management considers the unrealized losses to be market driven, resulting from changes in

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NOTE 2 – SECURITIES (Continued)

interest rates, and the Company has the intent and ability to hold the securities until their value recovers. Contractual maturities of debt securities at year end 2012 are presented below (in thousands). Expected maturities may differ from contractual maturity because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date, primarily mortgage-backed securities, are presented separately.

	Available for sale	Held to Maturity	
	Fair Value	Carrying Amount	Fair Value
Due in one year or less	$ 14,538	$ 1,447	$ 1,454
Due from one to five years	60,578	1,624	1,761
Due from five to ten years	1,025	1,436	1,704
Due after ten years	822	-	-
	76,963	4,507	4,919
Mortgage-backed	9,000	-	-
Collateralized mortgage obligations	11,838	-	-
Auction rate securities	1,000	-	-
Preferred shares	110	-	-
	$ 98,911	$ 4,507	$ 4,919

Securities pledged at December 31, 2012 totaled $16.7 million to secure borrowing capabilities with the Federal Home Loan Bank. There were no securities pledged at December 31, 2011. The Company did not have any borrowings as of December 31, 2012 or 2011.

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES

Year end loans were as follows:

	2012	2011
	(In thousands)	
Residential real estate	$ 51,434	$ 61,033
Consumer	4,638	5,124
Commercial real estate	48,168	48,110
Commercial	4,531	4,411
	108,771	118,678
Deferred loan origination fees, net	(248)	(245)
Allowance for loan losses	(3,638)	(3,339)
	$ 104,885	$ 115,094

(Continued)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The Company uses a seven grade risk rating system to monitor the ongoing credit quality of its commercial loan portfolio. These loan ratings rank the credit quality of a borrower by measuring liquidity, debt capacity, and payment behavior as shown in the borrower's financial statements. The loan ratings also measure the quality of the borrower's management and the repayment support offered by any guarantors. A summary of the Company's loan ratings (or, characteristics of the loans within each rating) follows:

Credit Quality Indicators

Risk Ratings 1-3 (Pass) — All loans in risk ratings 1— 3 are considered to be acceptable credit risks by the Company and are grouped for purposes of allowance for loan loss considerations and financial reporting. The three ratings essentially represent a ranking of loans that are all viewed to be of acceptable credit quality, taking into consideration the various factors mentioned above, but with varying degrees of financial strength, debt coverage, management and factors that could impact credit quality.

Risk Rating 4 (Special Mention) — A special mention business credit has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects or in the Company's credit position at some future date. Special mention business credits are not adversely ranked and do not expose the Company to sufficient risk to warrant adverse ranking.

Risk Rating 5 (Substandard) — A substandard business credit is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Business credit classified as substandard must have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. If the likelihood of full collection of interest and principal may be in doubt; such loans are placed on nonaccrual status.

Risk Rating 6 (Doubtful) — A business credit rated as doubtful has all the weaknesses inherent in substandard as risk rating 5 with the added characteristic that the weaknesses make collection or liquidation in full, on the basis or currently existing fact, conditions, and values, highly questionable and improbable. Due to the high probability of loss, nonaccrual treatment is required for doubtful rated loans.

Risk Rating 7 (Loss) — A business credit rated as loss is considered uncollectible and of such little value that its continuance as a collectable loan is not warranted. This rating does not necessarily result in absolutely no recovery or salvage value, but rather it is not practical or desirable to defer charging off even if partial recovery may be a consideration in the future.

(Continued)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents the recorded investment of loans in the commercial loan portfolio by risk rating categories at December 31:

	Commercial		Commercial Real Estate	
	2012	2011	2012	2011
	(In thousands)			
1 - 3	$ 4,481	$ 4,214	$ 38,615	$ 36,665
4	-	30	668	2,633
5	44	156	8,885	8,569
6	6	11	-	243
7	-	-	-	-
Total	$ 4,531	$ 4,411	$ 48,168	$ 48,110

The Company evaluates the credit quality of loans in the residential loan portfolio based primarily on the aging status of the loan, payment activity and credit quality indicators as defined above for business loans. The following schedule presents the recorded investment of loans in the residential loan portfolio based on the credit risk profile of loans in a pass, special mention and substandard rating at December 31:

	Residential	
	2012	2011
	(In thousands)	
Grade:		
Pass	$ 50,597	$ 60,608
Special mention	-	-
Substandard	837	425
Total	$ 51,434	$ 61,033

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The Company evaluates the credit quality of loans in the consumer loan portfolio, based primarily on the aging status of the loan. Accordingly loans past due as to principal or interest 90 days or more are considered in a nonperforming status for purposes of credit quality evaluation. The following schedule presents the recorded investment of loans in the consumer loan portfolio based on the credit risk profile of loans in a performing status and loans in a nonperforming status at December 31:

	Consumer	
	2012	2011
	(In thousands)	
Performing	$ 4,638	$ 5,124
Nonperforming	-	-
Total	$ 4,638	$ 5,124

Nonperforming Loans

Nonperforming loans include nonaccrual loans, accruing loans past due 90 days or more as to interest or principal payments and loans modified under troubled debt restructurings of the originated portfolio.

Nonperforming loans were as follows:

	2012	2011
	(In thousands)	
Loans past due over 90 days still on accrual	$ 12	$ -
Nonaccrual loans	4,633	1,979
Troubled debt restructurings	4,071	4,496
Total nonperforming loans	$ 8,716	$ 6,475

Detail of the loans on nonaccrual status by loan type as of December 31 is presented in the table below:

	2012	2011
	(In thousands)	
Commercial	$ 6	$ 22
Commercial real estate	4,533	1,876
Consumer	-	-
Residential	94	81
Total	$ 4,633	$ 1,979

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following schedule represents the aging analysis of past due loans by loan type at December 31 reported (in thousands):

	30-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loan	Accruing Loans 90 Days or More Days Past Due
2012						
Commercial	$ 10	$ -	$ 10	$ 4,521	$ 4,531	$ -
Commercial Real Estate	-	120	120	48,048	48,168	-
Consumer	9	-	9	4,629	4,638	-
Residential	759	98	857	50,577	51,434	12
Total	$ 778	$ 218	$ 996	$ 107,775	$ 108,771	$ 12
2011						
Commercial	$ 90	$ -	$ 90	$ 4,321	$ 4,411	$ -
Commercial Real Estate	126	-	126	47,984	48,110	-
Consumer	1	-	1	5,123	5,124	-
Residential	844	-	844	60,189	61,033	-
Total	$ 1,061	$ -	$ 1,061	$ 117,617	$ 118,678	$ -

The following schedule represents the modification activity for loans considered troubled debt restructurings that were modified during the years ended December 31, 2012 and 2011 (in thousands):

	Troubled Debit Restructurings					
	2012			**2011**		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial	-	$ -	$ -	-	$ -	$ -
Commercial Real Estate	7	$ 1,190	$ 1,190	11	$ 4,675	$ 4,675
Consumer	-	$ -	$ -	-	$ -	$ -
Residential	5	$ 811	$ 811	5	$ 530	$ 530

	Troubled Debt Restructurings That Subsequently Defaulted			
	2012		**2011**	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Commercial	-	$ -	-	$ -
Commercial Real Estate	-	$ -	1	$ 135
Consumer	-	$ -	-	$ -
Residential	-	$ -	-	$ -

(Continued)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired Loans

As described in Note 1, a loan is impaired when full payment under the loan terms is not expected. Impairment is evaluated in total for smaller-balance homogenous loans of similar nature such as residential mortgage, consumer, and credit card loans, and on an individual loan basis for other loans. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

There were forty eight loans in the real estate mortgage and commercial loan portfolios that were considered impaired as of year end 2012. Thirty one of the forty eight loans considered impaired have a valuation allowance against probable losses. There were thirty one loans in the real estate mortgage and commercial loan portfolios that were considered impaired as of year end 2011. Fifteen of the thirty one loans considered impaired have a valuation allowance against probable losses. Impaired loans as of December 31 are presented in the table below (in thousands):

		Recorded Investments					
	Unpaid Contractual Principal Balance	Loans With No Allowance	Loans With Allowance	Total Recorded Investment in Impaired Loans	Related Allowance	Average Impaired Loan Balance	Interest Income Recognized
2012							
Commercial	$ 43	$ -	$ 32	$ 32	$ 8	$ 35	$ 2
Commercial real estate	7,328	2,280	5,048	7,328	1,168	7,190	140
Residential	1,673	657	965	1,622	127	1,274	74
Total	$ 9,044	$ 2,937	$ 6,045	$ 8,982	$ 1,303	$ 8,499	$ 216
2011							
Commercial	$ 176	$ -	$ 108	$ 108	$ 82	$ 249	$ 1
Commercial real estate	5,683	3,271	2,412	5,683	952	4,094	79
Residential	786	266	487	753	47	411	21
Total	$ 6,645	$ 3,537	$ 3,007	$ 6,544	$ 1,081	$ 4,754	$ 101

(Continued)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Allowance for Loan Losses

The allowance for loan losses (allowance) provides for probable losses in the originated loan portfolio that have been identified with specific customer relationships and for probable losses believed to be inherent in the remainder of the originated loan portfolio but that have not been specifically identified. The allowance is comprised of specific allowances (assessed for originated loans that have known credit weaknesses), pooled allowances based on assigned risk ratings and historical loan loss experience for each loan type, and an unallocated allowance for imprecision in the subjective nature of the specific and pooled allowance methodology. Management evaluates the allowance on a quarterly basis in an effort to ensure the level is adequate to absorb probable losses inherent in the loan portfolio.

Activity in the allowance the year ended December 31 is summarized as follows:

	2012	2011
	(In thousands)	
Beginning balance	$ 3,339	$ 2,354
Provision for loan losses	1,010	3,015
Charge-offs	(876)	(2,368)
Recoveries	165	338
Ending Balance	$ 3,638	$ 3,339

The following schedule presents, by loan type, the changes in the allowance for the year ended December 31 and details regarding the balance in the allowance and the recorded investment in loans at December 31 by impairment evaluation method (in thousands).

	Commercial	Commercial Real Estate	Consumer	Residential	Unallocated	Total
2012						
Allowance for credit losses:						
Beginning balance	$ 158	$ 2,793	$ 35	$ 195	$ 158	$ 3,339
Charge-offs	(6)	(698)	(27)	(145)	-	$ (876)
Recoveries	29	80	15	41	-	$ 165
Provision	(109)	851	(7)	129	146	1,010
Ending Balance	$ 72	$ 3,026	$ 16	$ 220	$ 304	$ 3,638
Ending balance: individually evaluated for impairment	$ 8	$ 1,168	$ -	$ 127	$ -	$ 1,303
Ending balance: collectively evaluated for impairment	$ 64	$ 1,858	$ 16	$ 93	$ 304	$ 2,335

(Continued)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	Commercial	Commercial Real Estate	Consumer	Residential	Unallocated	Total
2011						
Allowance for credit losses:						
Beginning balance	$ 43	$ 2,000	$ 107	$ 186	$ 18	$ 2,354
Charge-offs	(436)	(1,786)	(26)	(120)	-	$ (2,368)
Recoveries	3	287	17	31	-	$ 338
Provision	548	2,292	(63)	98	140	3,015
Ending Balance	$ 158	$ 2,793	$ 35	$ 195	$ 158	$ 3,339
Ending balance: individually evaluated for impairment	$ 82	$ 952	$ -	$ 47	$ -	$ 1,081
Ending balance: collectively evaluated for impairment	$ 76	$ 1,841	$ 35	$ 148	$ 158	$ 2,258

NOTE 4 - LOAN SERVICING

Mortgage servicing rights are included in other assets on the balance sheet. For the two years ended December 31, activity for capitalized mortgage servicing rights was as follows:

	2012	2011
		(In thousands)
Mortgage Servicing Rights:		
Beginning of year	$ 607	$ 612
Additions	223	125
Amortization	(196)	(136)
Impairment valuation allowance	(18)	6
End of year	$ 616	$ 607
Loans servicing for others that have servicing rights capitalized	$ 81,068	$ 75,275

The fair value of mortgage servicing rights is estimated by calculating the present value of estimated future net servicing cash flows, taking into consideration the expected prepayment rates and other economic factors that are based on current market conditions. Increases in mortgage loan prepayments reduce estimated future net servicing cash flows because the life of the underlying loan is reduced. The fair value calculation is performed by a third-party model. Assumptions used in the 2012 model include, an average prepayment rate of 17.17% and an average discount rate of 7.93%. Assumptions used in the 2011 model include, an average prepayment rate of 18.17% and an average discount rate of 8.11%. The fair value of the

(Continued)

NOTE 4 - LOAN SERVICING (Continued)

mortgage servicing rights was last calculated as of November 30, 2012 and had a fair value of $637,000. At November 30, 2011 the fair value of the mortgage servicing rights was $676,000.

At December 31, 2011 the mortgage servicing rights had a valuation impairment of $6,000. As of December 31, 2012 the valuation impairment was $19,000.

Mortgage loans serviced for others are not reported as assets. Related escrow deposit balances were $182,000 and $171,000 at year end 2012 and 2011.

NOTE 5 – PREMISES AND EQUIPMENT

Year end premises and equipment were as follows:

	2012	2011
	(In thousands)	
Real estate and buildings	$ 7,247	$ 7,240
Furniture and fixtures	3,875	3,603
	11,122	10,843
Less accumulated depreciation	(5,942)	(5,634)
	$ 5,180	$ 5,209

Depreciation expense amounted to $379,000 and $391,000 in 2012 and 2011, respectively.

NOTE 6 – OTHER REAL ESTATE OWNED

During 2012 and 2011 the Bank foreclosed on certain loans secured by real estate and transferred this real estate collateral to other real estate in each of those years. At the time of acquisition, amounts were charged-off against the allowance for loan losses to bring the carrying amount of these properties to their estimated fair value, less estimated costs to sell. Gains or losses on the sale of other real estate are included in the non-interest income and non-interest expense, respectively, on the statement of operations.

(Continued)

NOTE 6 – OTHER REAL ESTATE OWNED (Continued)

	2012	2011
	(In thousands)	
Balance at beginning of year	$ 1,600	$ 2,180
Transfers from loans	57	3,740
Sales	(1,059)	(2,802)
Redemptions	(16)	(45)
Write-down adjustments	(37)	(1,534)
Gains on Sales	412	61
Balance at end of year	$ 957	$ 1,600

Management periodically reviews the other real estate owned properties for a valuation allowance to determine if the values of these properties have declined since the date of acquisition.

NOTE 7 - DEPOSITS

Time deposit accounts individually exceeding $100,000 total $23,185,000 and $23,834,000 at year end 2012 and 2011.

At year-end 2012, the scheduled maturities of time deposits are as follows:

	(In thousands)
2013	$ 35,538
2014	20,795
2015	6,029
2016	1,850
2017	1,644
	$ 65,856

(Continued)

NOTE 8 - EMPLOYEE BENEFITS

Defined Benefit Retirement Plan: The Company has a defined benefit, noncontributory pension plan which provides retirement benefits for the majority of the employees. The plan was amended to no longer accept new participants as of December 31, 2008. Current participants will receive benefits as originally outlined in the plan. The Company uses a December 31 measurement date for its plan. The following sets forth the plan's funded status and amounts recognized in the financial statements:

	2012	2011
	(In thousands)	
Change in benefit obligation:		
Beginning benefit obligation	$ (4,518)	$ (4,270)
Service cost	(171)	(167)
Interest cost	(289)	(274)
Actuarial gain/(loss)	(1,103)	49
Benefits paid	691	144
Ending benefit obligation	(5,390)	(4,518)
Change in plan assets, at fair value:		
Beginning plan assets	4,814	4,598
Actual return	608	(140)
Employer contribution	500	500
Benefits paid	(691)	(144)
Ending plan assets	5,231	4,814
Funded status	$ (159)	$ 296

Amounts recognized in the balance sheet consist of:

	2012	2011
	(In thousands)	
Pension funded status - other assets	$ -	$ 296
Pension funded status - other liabilities	159	-

The accumulated benefit obligation for the defined benefit pension plan was $4,334,000 and $3,795,000 at year end 2012 and 2011, respectively.

(Continued)

NOTE 8 - EMPLOYEE BENEFITS (Continued)

Components of net periodic benefit cost are as follows:

	2012	2011
	(In thousands)	
Service cost	$ 171	$ 167
Interest cost on benefit obligation	289	274
Expected return on plan assets	(407)	(384)
Net amortization and deferral	93	65
Pension expense	$ 146	$ 122

The estimated net (gain)/loss and prior service costs that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are $141,000 and $4,000, respectively.

The following weighted-average assumptions were used to determine benefit obligations at year end and net cost:

	2012	2011
Weighted average discount	5.50%	6.50%
Rate of increase in future compensation	3.00%	3.00%
Expected long term return on plan assets	8.00%	8.00%

The Company's pension plan asset allocation at year end 2012 and 2011, target allocation for 2013, and expected long-term rate of return by asset category are as follows:

Asset Category	Target Allocation 2013	Percentage of Plan Assets at Year end 2012	Percentage of Plan Assets at Year end 2011	Weighted-Average Expected Long-Term Rate of Return - 2013
Equity securities	70.0 %	74.2 %	63.2 %	10.00 %
Fixed Income securities	30.0	23.9	33.3	5.00
Other	-	1.9	3.5	0.05
Total	100.0 %	100.0 %	100.0 %	8.00 %

Plan assets were administered by Huntington National Bank as trustee of the plan. Management contracted Freedom One Financial to administer the pension plan assets as trustee of the plan effective March 2012. Freedom One Financial was acquired by CAPTRUST Financial Advisors effective December 31, 2012. Plan assets continue to be invested in diversified mutual funds.

(Continued)

NOTE 8 - EMPLOYEE BENEFITS (Continued)

The estimates of weighted average expected long-term rate of return is an estimate based on past performance and actual returns in the future are likely to vary over time.

The asset mix of the portfolio will be maintained by periodically re-balancing this account back to the stock and fixed income target allocations stated above.

The investments in the plan are managed for the benefits of the participants. They are structured to meet the cash flow necessary to pay retiring employees. ERISA guidelines for diversification of the investments are followed.

During 2012, the Company contributed $500,000 into the plan. The Company expects to contribute approximately $500,000 to this pension plan in 2013.

Estimated Future Payments

The following benefit payments, which reflect expected future service, are anticipated:

Year End	Benefit Payments (In thousands)
2013	$ 119
2014	116
2015	131
2016	130
2017	138
Years 2018 - 2023	1,715

Deferred Compensation Plan: The Company has a deferred compensation plan to provide retirement benefits to certain Directors, at their option, in lieu of annual directors' fees. The plan was amended as of December 31, 2009 and participants are no longer able to defer compensation in accordance with this plan and no additional benefits will accrue under this plan. The present value of future benefits was accrued annually over the period of active service of each participant using a 6.00% discount rate. Total liabilities under the plan are $2,826,000 and $2,821,000 at December 31, 2012 and 2011 and are included in other liabilities on the balance sheet. The expense for the plan was $236,000 and $221,000 in 2012 and 2011. Distributions under the plan were $231,000 and $211,000 in 2012 and 2011.

(Continued)

NOTE 8 - EMPLOYEE BENEFITS (Continued)

The following benefit payments reflect expected future cash flows as anticipated:

Year End	Benefit Payments
	(In thousands)
2013	$ 328
2014	327
2015	356
2016	356
2017	339
Years 2018 - 2028	2,298

The Company also has a deferred compensation plan that allows executive officers of the Bank, and certain Directors an opportunity to defer a portion of their compensation. On a monthly basis, the account of each participant accrues interest based on the interest rate determined for that year. Total liabilities under the plan are $814,000 and $810,000 at December 31, 2012 and 2011. The expense of the plan was $33,000 and $35,000 in 2012 and 2011.

401(k) Plan: The Company has a 401(k) savings and retirement plan covering substantially all employees. Under the plan, employees may defer up to the lesser of 100% of their eligible compensation or the limitations set by the IRS. The employees may also make "catch-up" contributions to the extent the IRS allows. During 2012 and 2011 the Board of Directors elected to contribute a matching contribution equal to 100% of the first 1%. The Board has elected to continue this match during 2013 for all employees participating in the pension plan. Effective April 1, 2013 the Board elected to match 100% of the first 5% for those employees not eligible to participate in the employee pension plan. Employee contributions and the Company's matching percentages are vested immediately. The Company's matching percentages are determined annually by the Board of Directors and resulted in total contributions of $27,000 and $28,000 in 2012 and 2011.

NOTE 9 - STOCK OPTIONS

Stock Option Plan: The shareholders approved an incentive stock option plan in May 1996 under which up to 67,005 options, as adjusted for stock splits, may be issued at market prices to employees over a 10 year period. The right to exercise the options vests over a one-year period. The exercise price of options granted is equivalent to the market value of underlying stock at the grant date. Shares issued when options are exercised come from authorized but unissued shares. All options outstanding are exercisable. Due to the plan end date, there were no options available for grant as of December 31, 2012 or 2011.

(Continued)

NOTE 9 - STOCK OPTIONS (Continued)

Activity in the option plan for the years ended is summarized as follows:

	Number of Outstanding Options	Exercise Price	Weighted Average Exercise Price	Weighted Average Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2011	4,462	$ 48.57	$ 48.57		
Exercised	-				
Expired	-				
Forfeitures	-				
Outstanding at December 31, 2011	4,462	$ 48.57	$ 48.57		
Exercised	-				
Expired	-				
Forfeitures	(420)				
Outstanding at December 31, 2012	4,042	$ 48.57	$ 48.57	1.0 years	-
Exercisable at December 31, 2012	4,042	$ 48.57	$ 48.57	1.0 years	-

No compensation expense was required to be recognized under the plan for 2012 and 2011. There was no unrecognized compensation expense at December 31, 2012. There were no options granted or exercised in 2012 and 2011.

NOTE 10 - INCOME TAXES

Income tax expense consists of:

	2012	2011
	(In thousands)	
Current benefit	$ -	$ -
Deferred expense (benefit)	(466)	1,703
	$ (466)	$ 1,703

NOTE 10 - INCOME TAXES (Continued)

Year end deferred tax assets and liabilities consist of:

	2012	2011
	(In thousands)	
Deferred tax assets		
Allowance for loan losses	$ 835	$ 727
Deferred compensation	1,238	1,234
Investment writedown	1,050	1,357
Capital loss carryforward	1,145	1,145
Pension liability	955	351
Net operating loss	805	793
AMT Credits	-	374
Other	517	548
Total deferred tax assets	6,545	6,529
Deferred tax liabilities		
Pension	901	781
Fixed assets	297	256
Mortgage servicing rights	209	206
Unrealized gains on securities available for sale	245	293
Accretion	48	54
Other	63	91
Total deferred tax liability	1,763	1,681
Net valuation allowance for capital losses	1,145	1,145
Net deferred tax asset	$ 3,637	$ 3,703

Net operating loss carry forwards of approximately $2.3 million will expire in 2031.

NOTE 11 - RELATED PARTY TRANSACTIONS

Certain directors and executive officers of the Company and the Bank (including family members, affiliates and companies in which they are principal owners) had loans outstanding with the Bank in the ordinary course of business. Related party loan balances totaled $609,000 and $1,058,000 at year end 2012 and 2011. Related party deposits totaled $4,649,000 and $3,848,000 at year end 2012 and 2011.

(Continued)

NOTE 12 - COMMITMENTS, OFF-BALANCE-SHEET RISK, AND CONTINGENCIES

There are various contingent liabilities that are not reflected in the financial statements, including claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material effect on the financial condition or result of operations of the Company.

At year end 2012 and 2011, reserves of $2,271,000 and $1,394,000 were required as deposits with the Federal Reserve or as cash on hand. These reserves do not earn interest.

Some financial instruments are used in the normal course of business to meet the financing needs of customers and to reduce exposure to interest rate changes. These financial instruments include commitments to extend credit and standby letters of credit. These involve, to a varying degree, credit and interest-rate risk in excess of the amount reported in the financial statements.

Exposure to credit loss if the other party does not perform is represented by the contractual amount for commitments to extend credit and standby letters of credit. The same credit policies are used for commitments and conditional obligations as are used for loans.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the commitment. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being used, the total commitments do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments to guarantee a customer's performance to a third party.

A summary of the unused contractual amounts of financial instruments with off-balance-sheet risk at year end were as follows:

	2012	2011
	(In thousands)	
Commitments to extend credit	$ 18,280	$ 16,918
Standby letters of credit	569	520

The fair values of these commitments are not material. Substantially all of these commitments are at variable or uncommitted rates.

(Continued)

NOTE 13 – FAIR VALUE MEASUREMENTS

The Company utilizes fair value measurements to record fair value adjustments of certain assets and liabilities and to determine fair value disclosure. The following presents information about the Company's assets measured at fair value on a recurring basis at December 31, 2012 and 2011 and the valuation techniques used by the Company to determine those fair values.

Fair Value Hierarchy
Under ASC 820, the Company groups assets and liabilities at fair value into three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1: In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that the company has the ability to access.

Level 2: Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs included quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3: Inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related assets or liabilities.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirely are categorized based on the lowest level input that is significant to the valuation. The Company's assessment of the significance of particular inputs to these fair value measurements required judgment and considers factors specific to each asset or liability.

The Company uses the following methods and significant assumptions to estimate fair value.

Securities classified as available for sale are generally reported at fair value utilizing Level 2 inputs where the Company obtains fair value measurements from an independent pricing service which uses matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows and the bonds' terms and conditions, among other things. Securities in Level 1 include preferred stock securities. Securities in Level 2 include U.S. Government agencies, mortgage-backed securities, corporate obligations, and state and municipal securities. The state and municipal portfolio also contains obligations issued by local municipalities and do not have a registered CUSIP. These bonds are classified based on Level 3 inputs. Additionally, the Company's auction rate securities, which are rarely traded, are also classified based on Level 3 inputs. Based on the lack of observable market data, the Company

(Continued)

NOTE 13 – FAIR VALUE MEASUREMENTS (Continued)

estimated fair values based on the observable data available and reasonable unobservable market data. The Company estimated fair value based on a discounted cash flow model which used appropriately adjusted discount rates reflecting credit and liquidity risks.

Investment securities available for sale are valued primarily by a third party pricing agent. Prices supplied by the independent pricing agent, as well as their pricing methodologies and assumptions, are reviewed for reasonableness and to ensure such prices are aligned with traditional pricing matrices. In general, our investment securities do not possess a complex structure that could introduce greater valuation risk. Pricing for such instruments is fairly generic and is easily obtained. On a quarterly basis, prices supplied by the pricing agent are validated by comparison to prices obtained from other third party sources for a material portion of the portfolio.

Both the market and income valuation approaches are implemented using the following types of inputs:

- Government-sponsored agency debt securities and corporate bonds are primarily priced using available market information through processes such as benchmark curves, market valuations of like securities, sector groupings and matrix pricing.
- Other government-sponsored mortgage-backed securities are primarily priced using available market information including benchmark yields, prepayment speeds, spreads and volatility of similar securities.
- Corporate obligations are primarily priced using consensus pricing and dealer quotes.
- State and municipal bonds are largely grouped by characteristics, i.e., geographical data and source of revenue in trade dissemination systems. Since some securities are not traded daily and due to other grouping limitations, active market quotes are often obtained using benchmarking for like securities. Local tax anticipation warrants, with very little market activity, are priced using an appropriate market yield curve.
- Auction rate securities are valued based on an expected cash flow valuation using the interest rate of the underlying securities. The securities owned by the Company are rarely traded and have an illiquid market.
- Preferred shares are primarily priced using the market approach and utilizing live data feeds from active market exchanges for identical securities.

(Continued)

NOTE 13 – FAIR VALUE MEASUREMENTS (Continued)

Disclosures concerning assets measured at fair value are as follows:

Assets and Liabilities Measured at Fair Value on a Recurring Basis at December 31,
(In thousands)

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31,
Assets				
2012				
Investment securities available-for-sale:				
U.S. Government and agency	$ -	$ 55,993	$ -	$ 55,993
Mortgage-backed	-	9,000	-	9,000
Collateralized mortgage obligations	-	11,838	-	11,838
State and municpal	-	-	20,970	20,970
Auction rate securities	-	-	1,000	1,000
Preferred shares	-	110	-	110
	$ -	$ 76,941	$ 21,970	$ 98,911
2011				
Investment securities available-for-sale:				
U.S. Government and agency	$ -	$ 52,915	$ -	$ 52,915
Mortgage-backed	-	15,168	-	15,168
State and municpal	-	-	8,914	8,914
Corporate obligations	-	1,009	-	1,009
Auction rate securities	-	-	1,000	1,000
Preferred shares	-	80	-	80
	$ -	$ 69,172	$ 9,914	$ 79,086

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis
(In thousands)

	Investment securities available-for-sale: 2012	2011
Balance at January 1,	$ 9,914	$ 11,527
Total realized and unrealized gains (losses) included in income	-	-
Total unrealized gains (losses) included in other comprehensive income	(46)	234
Net purchases, sales, calls and maturities	12,102	(1,847)
Net transfers in/out of Level 3	-	-
Balance at December 31,	$ 21,970	$ 9,914

(Continued)

NOTE 13 – FAIR VALUE MEASUREMENTS (Continued)

Both observable and unobservable inputs may be used to determine the fair value of positions classified as Level 3 assets and liabilities. As a result, the unrealized gains and losses for these assets presented in the tables above may include changes in fair value that were attributable to both observable and unobservable inputs.

The Company also reviews the fail value of certain assets, and if necessary, adjusts the carrying value of the assets to fair value on non-recurring basis.

Assets Measured at Fair Value on a Nonrecurring Basis at December 31,
(In thousands)

	Balance at December 31	Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
2012				
Impaired loans	$ 95	-	-	$ 95
Other real estate owned	900	-	-	900
2011				
Impaired loans	$ 25	-	-	$ 25
Other real estate owned	1,515	-	-	1,515

Impaired loans categorized as Level 3 assets consist of non-homogeneous loans that are considered impaired and had write-downs to fair value during the period. The Company estimates the fair value of the loans based on the present value of expected future cash flows using management's best estimate of key assumptions. These assumptions include future payments ability, timing of payment streams, and estimated realizable values of available collateral (typically based on outside appraisals).

The Company's other real estate owned is held at an estimated realizable value and that value changes periodically with the real estate market. Losses for the period associated with other real estate owned represent valuation adjustments and are write downs through the income statement.

(Continued)

NOTE 14 - FAIR VALUES OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate fair values for financial instruments. The carrying amount is considered to approximate fair value for cash and variable rate loans or deposits that reprice frequently and fully. Securities fair values are based on quoted market prices or, if no quotes are available, on the rate and term of the security and on information about the issuer. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, the fair value is estimated by discounted cash flow analysis or underlying collateral values, where applicable. The fair value of off-balance-sheet items approximates cost and is not considered significant to this presentation.

The estimated year end values of financial instruments were:

	2012		2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In thousands)			
Assets				
Cash and cash equivalents	$ 18,500	$ 18,500	$ 15,541	$ 15,541
Time deposits with other financial institutions	14,150	14,076	14,173	13,952
Securities available for sale	98,911	98,911	79,086	79,086
Securities held to maturity	4,507	4,919	4,653	5,121
Other securities	997	997	997	997
Loans held for sale	1,860	1,881	1,810	1,833
Loans, net	104,885	107,049	115,094	116,918
Accrued interest receivable on loans	347	347	432	432
Liabilities				
Deposits				
Noninterest-bearing	$ (57,615)	$ (57,615)	$ (49,956)	$ (49,956)
Interest bearing	(180,252)	(180,507)	(177,987)	(178,407)
Accrued interest payable on deposits	(31)	(31)	(35)	(35)

NOTE 15 - REGULATORY CAPITAL

The Bank is subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weightings and other factors, and the regulators can lower classifications in certain cases. Failure to meet various capital requirements can initiate regulatory action that could have a direct material effect on the financial statements.

(Continued)

NOTE 15 - REGULATORY CAPITAL (Continued)

The prompt corrective action regulations provide five classifications, including well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and plans for capital restoration are required.

The minimum requirements are:

	Capital to Risk-Weighted Assets		Tier 1 Capital
	Total	Tier 1	To Average Assets
Well Capitalized	10%	6%	5%
Adequately Capitalized	8%	4%	4%
Undercapitalized	6%	3%	3%

The Bank was categorized as well capitalized based on the criteria of prompt corrective action at year end. There are no conditions or events since year-end that management believes has changed the Bank's category. Actual capital levels (in millions) and minimum required levels were:

	Actual		Minimum Required For Capital Adequacy Purposes		Minimum Required To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2012						
Total capital (to risk weighted assets)						
Bank	$ 19.1	16.0 %	$ 9.5	8.0 %	$ 11.9	10.0 %
Tier 1 capital (to risk weighted assets)						
Bank	17.5	14.7	4.8	4.0	7.2	6.0
Tier 1 capital (to average assets)						
Bank	17.5	6.9	10.1	4.0	12.7	5.0
2011						
Total capital (to risk weighted assets)						
Bank	$ 16.9	14.0 %	$ 9.7	8.0 %	$ 12.1	10.0 %
Tier 1 capital (to risk weighted assets)						
Bank	15.4	12.7	4.8	4.0	7.3	6.0
Tier 1 capital (to average assets)						
Bank	15.4	6.2	9.9	4.0	12.4	5.0

(Continued)

NOTE 15 - REGULATORY CAPITAL (Continued)

One of the principal sources of cash for the Company is dividends from the Bank. Regulatory agencies can place dividend restrictions on the Bank based on their evaluation of its financial condition. No restrictions are currently imposed by regulatory agencies on the Bank other than the limitations found in the regulations which govern the payment of dividends to the Company. Under the most restrictive of these regulations, in 2013, the Bank is limited to paying dividends of the Company's net income of 2013 and the retained net income of the prior two calendar years. Under this calculation, allowable dividend payments during 2013 would be zero due to the cumulative net loss position for 2011 and 2012.

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*Directors of Citizens National Bank Only

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THOMAS A. ELLENBERGER
JOHN P. WARD

CNB CORPORATION COMMON STOCK

CNB Corporation common stock is listed on the OTC Markets and is traded under the symbol "CNBZ". The Company had 950 shareholders as of December 31, 2012.

SHAREHOLDER RELATIONS AND ANNUAL REPORT AVAILABLE

Shareholders may obtain, without charge, a copy of the 2012 Annual Report by submitting a written request to:

Shareholder Relations
CNB Corporation
303 N. Main St. P.O. Box 10,
Cheboygan, Michigan 49721.

The reports can also be downloaded from www.cnbismybank.com. Click on the shareholder relations link.

WEBSITE INFORMATION

The most current news releases and CNB Corporation financial reports and product information are available at our website, www.cnbismybank.com

ANNUAL MEETING

The Annual Meeting of Shareholders will be held on Tuesday, May 21, 2013 at the Knights of Columbus Hall, 9840 N. Straits Highway, Cheboygan, Michigan, 49721 at 7:00 p.m.

INDEPENDENT AUDITOR

Plante & Moran, PLLC
Grand Rapids, Michigan

STOCK SALES & MARKET MAKERS

Stock sales can be handled by stockbrokers serving as market makers. You may work with a broker of your choice or facilitate a private party sale. Market information for CNB Corporation is identified on the OTC Markets website at www.otcmarkets.com.

TRANSFER AGENT

The transfer agent for CNB Corporation continues to be Citizens National Bank. Inquiries regarding a change of name, address or ownership of stock, as well as information on shareholder records, lost or stolen certificates should be directed to shareholder relations.

The following table presents the high and low selling prices of known transactions in common stock of the Company for each quarter of 2012 and 2011.

	2012			2011		
	Market Price		Cash Dividends	Market Price		Cash Dividends
Quarter	High	Low	Declared	High	Low	Declared
1st	$ 8.10	$6.50	$ -	$10.25	$8.50	$ -
2nd	8.50	6.30	-	8.84	8.00	-
3rd	10.05	8.62	-	10.00	7.60	-
4th	11.15	8.00	-	8.50	6.50	-