CNB CORPORATION

2013
ANNUAL REPORT

303 North Main Street • Cheboygan, Michigan 49721 • Phone 231-627-7111

CNB CORPORATION
ANNUAL REPORT
December 31, 2013 and 2012

CONTENTS

CNB CORPORATION
ANNUAL SHAREHOLDERS' MEETING

Tuesday, May 20, 2014, 7:00 p.m. • Knights of Columbus Hall
Cheboygan, Michigan

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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, 2013 and 2012, and the related consolidated statements of operations, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

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 audits 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, 2013 and 2012, 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

March 31, 2014

CNB CORPORATION
CONSOLIDATED BALANCE SHEETS
December 31, 2013 and 2012

	2013	2012
	(In thousands, except share data)	
ASSETS		
Cash and due from banks	$ 8,424	$ 4,676
Interest-bearing deposits with other financial institutions	1,672	13,824
Total cash and cash equivalents	10,096	18,500
Time deposits with other financial institutions	11,169	14,150
Securities available for sale	84,374	98,911
Securities held to maturity	5,726	4,507
Other securities	997	997
Loans held for sale	882	1,860
Loans, net of allowance for loan losses of $3,076 in 2013 and $3,638 in 2012	118,492	104,885
Premises and equipment, net	5,109	5,180
Other assets	10,890	11,908
Total assets	$ 247,735	$ 260,898
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 54,045	$ 57,615
Interest-bearing	168,768	180,252
Total deposits	222,813	237,867
Other liabilities	4,102	4,315
Total liabilities	226,915	242,182
SHAREHOLDERS' EQUITY		
Common stock - $2.50 par value; 2,000,000 shares authorized; 1,212,098 shares issued and outstanding in 2013 and 2012	3,030	3,030
Additional paid-in capital	19,499	19,499
Retained Earnings (Accumulated deficit)	164	(2,435)
Accumulated other comprehensive loss, net of tax	(1,873)	(1,378)
Total shareholders' equity	20,820	18,716
Total liabilities and shareholders' equity	$ 247,735	$ 260,898

See accompanying notes to consolidated financial statements.

CNB CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
Years ended December 31, 2013 and 2012

	2013	2012
	(In thousands, except per share data)	
INTEREST INCOME		
Loans, including fees	$ 6,562	$ 6,995
Securities:		
Taxable	944	838
Tax exempt	264	323
Other interest income	151	214
Total interest income	7,921	8,370
INTEREST EXPENSE ON DEPOSITS	724	1,083
NET INTEREST INCOME	7,197	7,287
Provision for loan losses	(400)	1,010
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	7,597	6,277
NONINTEREST INCOME		
Service charges and fees	955	1,010
Net realized gains from sales of loans	465	720
Loan servicing fees, net of amortization	82	1
Gain on the sale of other real estate owned	215	412
Gains on the sale of securities	364	277
Securities impairment recovery	1,445	-
Other income	389	475
Total noninterest income	3,915	2,895
NONINTEREST EXPENSES		
Salaries and employee benefits	3,743	3,401
Deferred compensation	152	270
Pension	210	146
Hospitalization	593	554
Occupancy	1,011	934
Legal and professional	581	650
FDIC Premiums	344	344
Net (gain) losses and carrying costs on ORE	16	(112)
Other expenses	1,012	1,124
Total noninterest expense	7,662	7,311
INCOME BEFORE INCOME TAXES	3,850	1,861
Income tax expense	1,130	466
NET INCOME	$ 2,720	$ 1,395
Basic earnings per share	$ 2.24	$ 1.15
Diluted earnings per share	2.24	1.15

See accompanying notes to consolidated financial statements.

CNB CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years ended December 31, 2013 and 2012

	2013	2012
	(In thousands)	
Net income	$ 2,720	$ 1,395
Other comprehensive income (loss):		
Change in unrealized gain (loss) on securities available for sale	(1,109)	138
Less reclassification for gains realized during the year	(364)	(277)
Net change in unrealized gains (losses) on securities available for sale	(1,473)	(139)
Defined benefit pension plan:		
Net gain (loss) during the period	718	(880)
Prior service cost recognized during period	4	3
Tax effects	256	319
Total	(495)	(697)
Total comprehensive income (loss)	$ 2,225	$ 698

See accompanying notes to consolidated financial statements.

CNB CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years ended December 31, 2013 and 2012

	Outstanding Shares	Common Stock	Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss), Net of Tax	Total Shareholders' Equity
	(Dollars in thousands, except share data)					
Balance January 1, 2012	1,212,098	3,030	19,499	(3,830)	(681)	18,018
Net loss				1,395		1,395
Other comprehensive income (loss)					(697)	(697)
Balance December 31, 2012	1,212,098	3,030	19,499	(2,435)	(1,378)	18,716
Net income				2,720		2,720
Cash dividends - $0.10 per share				(121)		(121)
Other comprehensive income (loss)					(495)	(495)
Balance December 31, 2013	1,212,098	$ 3,030	$ 19,499	$ 164	$ (1,873)	$ 20,820

See accompanying notes to consolidated financial statements.

CNB CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2013 and 2012

	2013	2012
	(In thousands)	
Cash flows from operating activities		
Net income	$ 2,720	$ 1,395
Adjustments to reconcile net income to		
net cash from operating activities:		
Depreciation, amortization and accretion, net	998	610
Provision for loan losses	(400)	1,010
Loans originated for sale	(21,427)	(31,634)
Proceeds from sales of loans originated for sale	20,865	30,271
Gain on sales of investment securities	(364)	(277)
Gain on sales of loans	(465)	(720)
Gain on sales of other real estate owned properties	(215)	(412)
Other real estate owned writedowns	15	37
Increase in cash surrender value of life insurance	(119)	(136)
Increase in deferred tax benefit	255	718
Decrease in other assets	785	1,028
Increase (decrease) in other liabilities	510	(783)
Total adjustments	438	(288)
Net cash provided by operating activities	3,158	1,107
Cash flows from investing activities		
Proceeds from sales of securities available for sale	22,270	14,934
Proceeds from maturities of securities available for sale	14,353	36,994
Purchase of securities available for sale	(23,797)	(71,847)
Proceeds from maturities of securities held to maturity	2,381	1,796
Purchase of securities held to maturity	(3,600)	(1,650)
Proceeds from maturities of time deposits	4,227	5,771
Purchase of time deposits	(1,246)	(5,748)
Net change in portfolio loans	(12,263)	10,952
Premises and equipment expenditures	(325)	(349)
Proceeds from sales & redemptions of other real estate owned properties	1,613	1,075
Net cash provided by (used in) investing activities	3,613	(8,072)
Cash flows from financing activities		
Net increase (decrease) in deposits	(15,054)	9,924
Dividends paid	(121)	-
Net cash provided by (used) in financing activities	(15,175)	9,924
Net change in cash and cash equivalents	(8,404)	2,959
Cash and cash equivalents at beginning of year	18,500	15,541
Cash and cash equivalents at end of year	$ 10,096	$ 18,500
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest	$ 742	$ 1,088
Income taxes	51	-
Non-cash transactions:		
Transfer from loans to other real estate owned	1,118	57

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 and a loan production office in Otsego County 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.

(Continued)

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, 2013 and 2012, the cash surrender value of the underlying policies was $4,392,000 and $4,499,000, 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. Discretionary 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 2012 or 2013. As of December 31, 2013 all options issued under the plan have expired.

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. The components of accumulated other comprehensive income (loss) consisted of unrealized gains (losses) on securities and defined benefit pension obligation of approximately ($495,000) and ($1,378,000) in 2013 and $478,000 and ($1,856,000) in 2012, respectively.

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 2013 and 2012.

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:
In January 2014, the FASB issued ASU No. 2014-04, *Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40) Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force).* The amendments in the ASU clarify when an in-substance repossession or foreclosure occurs – that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The new ASU requires a creditor to reclassify a collateralized consumer mortgage loan to real estate property upon obtaining legal titled to the real estate collateral, or the borrower voluntarily conveying all interest in the real estate property to the lender to satisfy the loan through a deed in lieu of foreclosure or similar legal agreement. The ASU is effective for the Company beginning January 1, 2015. The provisions of this guidance are not expected to have a significant impact on the consolidated financial condition, results of operation or the liquidity of the Company.

In July 2013, the FASB issued ASU 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists* (a consensus of the Emerging Issues Task Force). ASU 2013-11 requires that an unrecognized tax benefit be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward except as follows: To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. The provisions of this guidance are not expected to have a significant impact on the consolidated financial condition, results of operation or the liquidity of the Company.

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* ("ASU 2013-02"), to improve the reporting of reclassifications out of accumulated other comprehensive income. ASU 2013-02 requires that an entity report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles ("GAAP") to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about these amounts. ASU 2013-02 is effective prospectively for reporting periods beginning after December 15, 2012. The Company adopted ASU 2013-02 as of January 1, 2013. The adoption of ASU 2013-02 did not have a material impact on the Company's financial condition or results of operations.

<u>Subsequent Events</u>: The financial statements and related disclosures include evaluation of events up through and including March 31, 2014, which is the date the financial statements were available to be issued.

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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)	
2013			
U.S. Government and agency	$ 30,328	$ 52	$ (74)
Mortgage-backed	15,983	15	(281)
Collateralized mortgage obligations	18,543	-	(612)
State and municipal	18,520	244	(94)
Auction rate securities	1,000	-	-
	$ 84,374	$ 311	$ (1,061)
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)

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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)		
2013				
State and municipal	$ 5,726	$ 288	$ -	$ 6,014
2012				
State and municipal	$ 4,507	$ 412	$ -	$ 4,919

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 2012, the Company sold fifteen investments. Proceeds from the sale were $14.9 million and gains of $277,000 were recorded from the sales. During 2013, the Company sold fifteen investments. Proceeds from the sale were $22.3 million and gains of $385,000 and losses of

(Continued)

NOTE 2 – SECURITIES (Continued)

$21,000 were recorded from the sales. Recoveries of $1,445,000 were received from previously written off bonds.

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

2013	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	$ 8,893	$ (66)	$ 1,029	$ (8)	9,922	$ (74)
Mortgage-backed	11,328	(184)	3,534	(97)	14,862	(281)
Collateralized mortgage obligations	18,543	(612)	-	-	18,543	(612)
State and municipal	9,213	(81)	2,261	(13)	11,474	(94)
Total temporarily impaired	$ 47,977	$ (943)	$ 6,824	$ (118)	$ 54,801	$ (1,061)

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)

In 2013, there were 53 securities with unrealized losses and in 2012 there were 30 securities. These unrealized losses remaining on the balance sheet at year end 2013 and 2012 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 interest rates, and the Company has the intent and ability to hold the securities until their value recovers.

(Continued)

NOTE 2 – SECURITIES (Continued)

Contractual maturities of debt securities at year end 2013 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 Fair Value	Held to Maturity Carrying Amount	Held to Maturity Fair Value
Due in one year or less	$ 7,407	$ 1,723	$ 1,729
Due from one to five years	39,868	2,878	2,998
Due from five to ten years	1,029	1,125	1,287
Due after ten years	544	-	-
	48,848	5,726	6,014
Mortgage-backed	15,983	-	-
Collateralized mortgage obligations	18,543	-	-
Auction rate securities	1,000	-	-
	$ 84,374	$ 5,726	$ 6,014

Securities pledged at December 31, 2013 and 2012 totaled $17.9 million and $16.7 million, respectively, to secure borrowing capabilities with the Federal Home Loan Bank. The Company did not have any borrowings as of December 31, 2013 or 2012.

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES

Year end loans were as follows:

	2013	2012
	(In thousands)	
Residential real estate	$ 56,368	$ 51,434
Consumer	6,046	4,638
Commercial real estate	54,384	48,168
Commercial	5,081	4,531
	121,879	108,771
Deferred loan origination fees, net	(311)	(248)
Allowance for loan losses	(3,076)	(3,638)
	$ 118,492	$ 104,885

(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.

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**	
	2013	2012	2013	2012
	(In thousands)			
1 - 3	$ 4,847	$ 4,481	$ 48,936	$ 38,615
4	222	-	1,668	668
5	12	44	3,226	8,885
6	-	6	554	-
7	-	-	-	-
Total	$ 5,081	$ 4,531	$ 54,384	$ 48,168

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	
	2013	2012
	(In thousands)	
Grade:		
Pass	$ 55,911	$ 50,597
Special mention	-	-
Substandard	457	837
Total	$ 56,368	$ 51,434

(Continued)

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	
	2013	2012
	(In thousands)	
Performing	$ 6,046	$ 4,638
Nonperforming	-	-
Total	$ 6,046	$ 4,638

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:

	2013	2012
	(In thousands)	
Loans past due over 90 days still on accrual	$ 143	$ 12
Nonaccrual loans	2,001	4,633
Troubled debt restructurings	3,586	4,071
Accruing impaired loans	93	266
Total nonperforming loans	$ 5,823	$ 8,982

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

	2013	2012
	(In thousands)	
Commercial	$ 1	$ 6
Commercial real estate	1,996	4,533
Consumer	-	-
Residential	4	94
Total	$ 2,001	$ 4,633

(Continued)

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
2013						
Commercial	$ 35	$ -	$ 35	$ 5,046	$ 5,081	$ -
Commercial Real Estate	32	1,164	1,196	53,188	54,384	-
Consumer	17	-	17	6,029	6,046	-
Residential	1,882	143	2,025	54,343	56,368	143
Total	$ 1,966	$ 1,307	$ 3,273	$ 118,606	$ 121,879	$ 143
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

The following schedule represents the modification activity for loans considered troubled debt restructurings that were modified during the years ended December 31, 2013 and 2012 (in thousands):

	Troubled Debit Restructurings					
	2013			2012		
	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	5	$ 2,098	$ 1,688	7	$ 1,190	$ 1,190
Consumer	-	$ -	$ -	-	$ -	$ -
Residential	-	$ -	$ -	5	$ 811	$ 811

	Troubled Debt Restructurings That Subsequently Defaulted			
	2013		2012	
	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 thirty three loans in the real estate mortgage and commercial loan portfolios that were considered impaired as of year end 2013. Twenty seven of the thirty three loans considered impaired have a valuation allowance against probable losses. 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. 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
2013							
Commercial	$ 34	$ -	$ 34	$ 34	$ 12	$ 39	$ 2
Commercial real estate	4,616	445	4,171	4,616	1,019	6,064	150
Residential	1,190	254	919	1,173	113	1,286	57
Total	$ 5,840	$ 699	$ 5,124	$ 5,823	$ 1,144	$ 7,390	$ 209
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

(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:

	2013	2012
	(In thousands)	
Beginning balance	$ 3,638	$ 3,339
Provision (benefit) for loan losses	(400)	1,010
Charge-offs	(270)	(876)
Recoveries	108	165
Ending Balance	$ 3,076	$ 3,638

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
2013						
Allowance for credit losses:						
Beginning balance	$ 72	$ 3,026	$ 16	$ 220	$ 304	$ 3,638
Charge-offs	-	(84)	(30)	(156)	-	$ (270)
Recoveries	13	49	25	21	-	$ 108
Benefit	(21)	(594)	(7)	337	(115)	(400)
Ending Balance	$ 64	$ 2,397	$ 4	$ 422	$ 189	$ 3,076
Ending balance: individually evaluated for impairment	$ 12	$ 1,019	$ -	$ 113	$ -	$ 1,144
Ending balance: collectively evaluated for impairment	$ 52	$ 1,378	$ 4	$ 309	$ 189	$ 1,932

(Continued)

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

	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

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:

	2013	2012
	(In thousands)	
Mortgage Servicing Rights:		
Beginning of year	$ 616	$ 607
Additions	145	223
Amortization	(128)	(196)
Impairment valuation allowance	19	(18)
End of year	$ 652	$ 616
Loans serviced for others	$ 83,620	$ 81,068

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 2013 model include, an average prepayment rate of 10.04% and an average discount rate of 8.45%. Assumptions used in the 2012 model include, an average prepayment rate of 17.17% and an average discount rate of 7.93%. The fair value of the

(Continued)

NOTE 4 - LOAN SERVICING (Continued)

mortgage servicing rights was last calculated as of November 30, 2013 and had a fair value of $824,000. At November 30, 2012 the fair value of the mortgage servicing rights was $637,000.

At December 31, 2012 the mortgage servicing rights had a valuation impairment of $19,000. There was no valuation impairment as of December 31, 2013.

Mortgage loans serviced for others are not reported as assets. Related escrow deposit balances were $212,000 and $182,000 at year end 2013 and 2012.

NOTE 5 – PREMISES AND EQUIPMENT

Year end premises and equipment were as follows:

	2013	2012
	(In thousands)	
Real estate and buildings	$ 7,399	$ 7,247
Furniture and fixtures	3,859	3,875
	11,258	11,122
Less accumulated depreciation	(6,149)	(5,942)
	$ 5,109	$ 5,180

Depreciation expense amounted to $396,000 and $379,000 in 2013 and 2012, respectively.

NOTE 6 – OTHER REAL ESTATE OWNED

During 2013 and 2012 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)

	2013	2012
	(In thousands)	
Balance at beginning of year	$ 957	$ 1,600
Transfers from loans	1,118	57
Sales	(1,398)	(647)
Redemptions	-	(16)
Write-down adjustments	(15)	(37)
Balance at end of year	$ 662	$ 957

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 $19,594,000 and $23,185,000 at year end 2013 and 2012.

At year-end 2013, the scheduled maturities of time deposits are as follows:

	(In thousands)
2014	$ 29,849
2015	10,932
2016	10,267
2017	1,801
2018	1,791
	$ 54,640

(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:

	2013	2012
	(In thousands)	
Change in benefit obligation:		
Beginning benefit obligation	$ (5,390)	$ (4,518)
Service cost	(216)	(171)
Interest cost	(293)	(289)
Actuarial gain/(loss)	(22)	(1,103)
Benefits paid	736	691
Ending benefit obligation	(5,185)	(5,390)
Change in plan assets, at fair value:		
Beginning plan assets	5,231	4,814
Actual return	1,043	608
Employer contribution	500	500
Benefits paid	(736)	(691)
Ending plan assets	6,038	5,231
Funded status	$ 853	$ (159)

Amounts recognized in the balance sheet consist of:

	2013	2012
	(In thousands)	
Pension funded status - other assets	$ 853	$ -
Pension funded status - other liabilities	-	159

The accumulated benefit obligation for the defined benefit pension plan was $3,964,000 and $4,334,000 at year end 2013 and 2012, respectively.

(Continued)

NOTE 8 - EMPLOYEE BENEFITS (Continued)

Components of net periodic benefit cost are as follows:

	2013	2012
	(In thousands)	
Service cost	$ 216	$ 171
Interest cost on benefit obligation	293	289
Expected return on plan assets	(444)	(407)
Net amortization and deferral	145	93
Pension expense	$ 210	$ 146

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 $93,000 and $4,000, respectively.

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

	2013	2012
Weighted average discount	5.50%	5.50%
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 2013 and 2012, target allocation for 2014, and expected long-term rate of return by asset category are as follows:

Asset Category	Target Allocation 2014	Percentage of Plan Assets at Year end 2013	Percentage of Plan Assets at Year end 2012	Weighted-Average Expected Long-Term Rate of Return - 2014
Equity securities	70.0 %	74.3 %	74.2 %	10.00 %
Fixed Income securities	30.0	24.0	23.9	5.00
Other	-	1.7	1.9	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 2013, the Company contributed $500,000 into the plan. The Company expects to make no contribution to this pension plan in 2014.

Estimated Future Payments

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

Year End	Benefit Payments (In thousands)
2014	$ 64
2015	64
2016	63
2017	73
2018	138
Years 2019 - 2024	1,753

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 $2,626,000 and $2,826,000 at December 31, 2013 and 2012 and are included in other liabilities on the balance sheet. The expense for the plan was $123,000 and $236,000 in 2013 and 2012. Distributions under the plan were $323,000 and $231,000 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)
2014	$ 314
2015	342
2016	342
2017	342
2018	329
Years 2019 - 2029	1,860

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 $843,000 and $814,000 at December 31, 2013 and 2012. The expense of the plan was $29,000 and $33,000 in 2013 and 2012.

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 2013 and 2012 the Board of Directors elected o contribute a matching contribution equal to 100% of the first 1%. 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. The Board has elected to continue each of the match programs during 2014. 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 $36,000 and $27,000 in 2013 and 2012.

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, 2013 or 2012.

(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, 2012	4,462	$ 48.57	$ 48.57		
Exercised	-				
Expired	-				
Forfeitures	(420)				
Outstanding at December 31, 2012	4,042	$ 48.57	$ 48.57		
Exercised	-				
Expired	(4,042)				
Forfeitures	-				
Outstanding at December 31, 2013	-	$ -	$ -	0 years	-
Exercisable at December 31, 2013	-	$ -	$ -	0 years	-

No compensation expense was required to be recognized under the plan for 2013 and 2012. There was no unrecognized compensation expense at December 31, 2013. There were no options granted or exercised in 2013 and 2012.

NOTE 10 - INCOME TAXES

Income tax expense consists of:

	2013	2012
	(In thousands)	
Current benefit	$ -	$ -
Deferred benefit	(255)	(466)
	$ (255)	$ (466)

(Continued)

NOTE 10 - INCOME TAXES (Continued)

Year end deferred tax assets and liabilities consist of:

	2013	2012
	(In thousands)	
Deferred tax assets		
Allowance for loan losses	$ 613	$ 835
Deferred compensation	1,180	1,238
Investment writedown	-	1,357
Capital loss carryforward	1,144	1,144
Pension liability	710	955
Net operating loss	1,178	570
AMT tax credits	395	395
Unrealized losses on securities available for sale	255	-
Other	220	168
Total deferred tax assets	5,695	6,662
Deferred tax liabilities		
Pension	999	901
Fixed assets	251	244
Mortgage servicing rights	222	209
Unrealized gains on securities available for sale	-	245
Accretion	43	48
Other	37	33
Total deferred tax liability	1,552	1,680
Net valuation allowance for capital losses	1,144	1,144
Net deferred tax asset	$ 2,999	$ 3,838

Net operating loss carry forwards of approximately $3.5 million will expire between 2031 and 2034.

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 $1,052,000 and $609,000 at year end 2013 and 2012. Related party deposits totaled $4,561,000 and $4,649,000 at year end 2013 and 2012.

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 2013 and 2012, reserves of $1,958,000 and $2,271,000 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:

	2013	2012
	(In thousands)	
Commitments to extend credit	$ 19,350	$ 18,280
Standby letters of credit	455	569

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, 2013 and 2012 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				
2013				
Investment securities available-for-sale:				
U.S. Government and agency	$ -	$ 30,328	$ -	$ 30,328
Mortgage-backed	-	15,983	-	15,983
Collateralized mortgage obligation:	-	18,543	-	18,543
State and municpal	-	-	18,520	18,520
Auction rate securities	-	-	1,000	1,000
	$ -	$ 64,854	$ 19,520	$ 84,374
2012				
Investment securities available-for-sale:				
U.S. Government and agency	$ -	$ 55,993	$ -	$ 55,993
Mortgage-backed	-	9,000	-	9,000
Collateralized mortgage obligation:	-	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

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

	Investment securities available-for-sale:	
	2013	2012
Balance at January 1,	$ 21,970	$ 9,914
Total realized and unrealized gains (losses) included in income	-	-
Total unrealized gains (losses) included in other comprehensive income	(223)	(46)
Net purchases, sales, calls and maturities	(2,227)	12,102
Net transfers in/out of Level 3	-	-
Balance at December 31,	$ 19,520	$ 21,970

(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)

Assets	Balance at December 31	Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
2013				
Impaired loans	$ 4	-	-	$ 4
2012				
Impaired loans	$ 95	-	-	$ 95
Other real estate owned	900	-	-	900

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:

	2013		2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In thousands)			
Assets				
Cash and cash equivalents	$ 10,096	$ 10,096	$ 18,500	$ 18,500
Time deposits with other financial institutions	11,169	11,180	14,150	14,076
Securities available for sale	84,374	84,374	98,911	98,911
Securities held to maturity	5,726	6,014	4,507	4,919
Other securities	997	997	997	997
Loans held for sale	882	896	1,860	1,881
Loans, net	118,492	134,412	104,885	107,049
Accrued interest receivable on loans	368	368	347	347
Liabilities				
Deposits				
Noninterest-bearing	$ (54,045)	$ (54,045)	$ (57,615)	$ (57,615)
Interest bearing	(168,768)	(168,829)	(180,252)	(180,507)
Accrued interest payable on deposits	(13)	(13)	(31)	(31)

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
2013						
Total capital (to risk weighted assets)						
Bank	$ 22.4	17.0 %	$ 10.6	8.0 %	$ 13.2	10.0 %
Tier 1 capital (to risk weighted assets)						
Bank	20.8	15.7	5.3	4.0	7.9	6.0
Tier 1 capital (to average assets)						
Bank	20.8	8.5	9.8	4.0	12.3	5.0
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	12.4	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 2014, the Bank is limited to paying dividends of the Company's net income of 2014 and the retained net income of the prior two calendar years. Under this calculation, allowable dividend payments during 2014 would be $3,994,000 plus 2014 net income, without prior regulatory approval.

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DOUGLAS W. DAMM
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CITIZENS NATIONAL BANK OFFICERS

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GINA L. EUSTICE
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INDIAN RIVER

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Kurt Blaskowski
Quinn Bonnett
Maghan Brooks
Bridget Brown
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Matthew DeWildt
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Sherri Kosan
Amber Wormell

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Debbie Altman

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Retired President, Anchor In Marina

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Retired, Indian River Veterinary Clinic

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Vice President & Secretary
Albert Ellenberger Lumber Company

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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 929 shareholders as of December 31, 2013.

SHAREHOLDER RELATIONS AND ANNUAL REPORT AVAILABLE

Shareholders may obtain, without charge, a copy of the 2013 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 20, 2014 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 2013 and 2012.

	2013			2012		
	Market Price		Cash Dividends	Market Price		Cash Dividends
Quarter	High	Low	Declared	High	Low	Declared
1st	$11.00	$ 9.55	$ -	$ 8.10	$6.50	$ -
2nd	12.00	10.50	-	8.50	6.30	-
3rd	12.50	10.35	0.10	10.05	8.62	-
4th	12.00	9.82	-	11.15	8.00	-