

CNB FINANCIAL CORP/PA  
Form 10-Q  
November 03, 2016  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10 - Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2016

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 000-13396

**CNB FINANCIAL CORPORATION**

(Exact name of registrant as specified in its charter)

**Pennsylvania**  
(State or other jurisdiction of  
incorporation or organization)

**25-1450605**  
(I.R.S. Employer  
Identification No.)

**1 South Second Street**

**P.O. Box 42**

**Clearfield, Pennsylvania 16830**

(Address of principal executive offices)

**Registrant's telephone number, including area code, (814) 765-9621**

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

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

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

The number of shares outstanding of the issuer's common stock as of November 1, 2016

COMMON STOCK NO PAR VALUE PER SHARE: 14,465,942 SHARES

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**FINANCIAL INFORMATION**

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### **Forward-Looking Statements**

This quarterly report on form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, with respect to the financial condition, liquidity, results of operations, future performance and our business. These forward-looking statements are intended to be covered by the safe harbor for

forward-looking statements provided by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are those that are not historical facts. Forward-looking statements include statements with respect to beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions that are subject to significant risks and uncertainties and are subject to change based on various factors (some of which are beyond our control). Forward-looking statements often include the words believes, expects, anticipates, estimates, forecasts, intends, targets, potentially, probably, projects, outlook or similar expressions or future conditional verbs such as may, will, should, would. Such known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from the statements, include, but are not limited to, (i) changes in general business, industry or economic conditions or competition; (ii) changes in any applicable law, rule, regulation, policy, guideline or practice governing or affecting financial holding companies and their subsidiaries or with respect to tax or accounting principles or otherwise; (iii) adverse changes or conditions in capital and financial markets; (iv) changes in interest rates; (v) higher than expected costs or other difficulties related to integration of combined or merged businesses; (vi) the inability to realize expected cost savings or achieve other anticipated benefits in connection with business combinations and other acquisitions; (vii) changes in the quality or composition of our loan and investment portfolios; (viii) adequacy of loan loss reserves; (ix) increased competition; (x) loss of certain key officers; (xi) continued relationships with major customers; (xii) deposit attrition; (xiii) rapidly changing technology; (xiv) unanticipated regulatory or judicial proceedings and liabilities and other costs; (xv) changes in the cost of funds, demand for loan products or demand for financial services; (xvi) other economic, competitive, governmental or technological factors affecting our operations, markets, products, services and prices; and (xvii) our success at managing the foregoing items. Some of these and other factors are discussed in our annual and quarterly reports filed with the Securities and Exchange Commission (SEC). Such factors could have an adverse impact on our financial position and our results of operations.

The forward-looking statements contained herein are based upon management's beliefs and assumptions. Any forward-looking statement made herein speaks only as of the date on which it is made. Factors or events that could cause our actual results to differ may emerge from time to time, and it is not possible for us to predict all of them. We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by law.

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## Part I Financial Information

## Item 1. Financial Statements

## CONSOLIDATED BALANCE SHEETS

Dollars in thousands, except share data

|   | (unaudited)<br>September 30,<br>2016 | December 31,<br>2015 |
|---|--------------------------------------|----------------------|
| <b><u>ASSETS</u></b>  |                                      |                      |
| Cash and due from banks   | \$ 34,787                            | \$ 23,302            |
| Interest bearing deposits with other banks  | 2,117                                | 3,959                |
| Total cash and cash equivalents   | 36,904                               | 27,261               |
| Securities available for sale   | 506,744                              | 546,043              |
| Trading securities  | 4,644                                | 4,576                |
| Loans held for sale   | 2,814                                | 1,381                |
| Loans   | 1,804,472                            | 1,582,354            |
| Less: unearned discount   | (3,614)                              | (4,556)              |
| Less: allowance for loan losses   | (15,703)                             | (16,737)             |
| Net loans   | 1,785,155                            | 1,561,061            |
| FHLB and other equity interests   | 18,334                               | 15,921               |
| Premises and equipment, net   | 46,335                               | 39,370               |
| Bank owned life insurance   | 43,998                               | 41,039               |
| Mortgage servicing rights   | 1,052                                | 962                  |
| Goodwill  | 38,967                               | 27,194               |
| Core deposit intangible   | 3,200                                | 2,395                |
| Accrued interest receivable and other assets  | 51,797                               | 17,933               |
| Total Assets  | \$ 2,539,944                         | \$ 2,285,136         |
| <b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>  |                                      |                      |
| Non-interest bearing deposits   | \$ 293,049                           | \$ 263,639           |
| Interest bearing deposits   | 1,730,732                            | 1,551,414            |
| Total deposits  | 2,023,781                            | 1,815,053            |
| FHLB and other long-term borrowings   | 129,202                              | 104,243              |
| Other short-term borrowings   | 76,000                               | 116,272              |
| Subordinated debentures   | 70,620                               | 20,620               |
| Accrued interest payable and other liabilities  | 24,852                               | 27,035               |
| Total liabilities   | 2,324,455                            | 2,083,223            |
| Common stock, \$0 par value; authorized 50,000,000 shares; issued 14,473,482 shares                 | 0                                    | 0                    |
| Additional paid in capital  | 77,543                               | 77,827               |
| Retained earnings   | 131,643                              | 123,301              |
| Treasury stock, at cost (8,272 shares at September 30, 2016 and 65,052 shares at December 31, 2015) | (163)                                | (1,114)              |
| Accumulated other comprehensive income  | 6,466                                | 1,899                |

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|  |              |              |
|--|--------------|--------------|
| Total shareholders' equity                 | 215,489      | 201,913      |
| Total Liabilities and Shareholders' Equity | \$ 2,539,944 | \$ 2,285,136 |

See Notes to Consolidated Financial Statements

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## CONSOLIDATED STATEMENTS OF INCOME (unaudited)

Dollars in thousands, except per share data

|   | Three months ended<br>September 30, |               |
|---|-------------------------------------|---------------|
|   | 2016                                | 2015          |
| <b>INTEREST AND DIVIDEND INCOME:</b>  |                                     |               |
| Loans including fees  | \$ 21,749                           | \$ 18,459     |
| <b>Securities:</b>  |                                     |               |
| Taxable   | 2,257                               | 2,692         |
| Tax-exempt  | 825                                 | 972           |
| Dividends   | 127                                 | 114           |
| <b>Total interest and dividend income</b>   | <b>24,958</b>                       | <b>22,237</b> |
| <b>INTEREST EXPENSE:</b>  |                                     |               |
| Deposits  | 2,195                               | 2,169         |
| Borrowed funds  | 633                                 | 841           |
| Subordinated debentures (includes \$84 and \$95 accumulated other comprehensive income reclassification for change in fair value of interest rate swap agreements in 2016 and 2015, respectively)                           | 197                                 | 189           |
| <b>Total interest expense</b>   | <b>3,025</b>                        | <b>3,199</b>  |
| <b>NET INTEREST INCOME</b>  | <b>21,933</b>                       | <b>19,038</b> |
| <b>PROVISION FOR LOAN LOSSES</b>  | <b>622</b>                          | <b>463</b>    |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>  | <b>21,311</b>                       | <b>18,575</b> |
| <b>NON-INTEREST INCOME:</b>   |                                     |               |
| Wealth and asset management fees  | 795                                 | 711           |
| Service charges on deposit accounts   | 1,162                               | 1,171         |
| Other service charges and fees  | 653                                 | 838           |
| Net realized gains on available-for-sale securities (includes \$0 and \$73 accumulated other comprehensive income reclassifications for net realized gains on available-for-sale securities in 2016 and 2015, respectively) | 0                                   | 73            |
| Net realized and unrealized gains (losses) on trading securities  | 235                                 | (260)         |
| Mortgage banking  | 388                                 | 164           |
| Bank owned life insurance   | 281                                 | 288           |
| Card processing and interchange income  | 876                                 | 873           |
| Other   | 81                                  | 136           |
| <b>Total non-interest income</b>  | <b>4,471</b>                        | <b>3,994</b>  |
| <b>NON-INTEREST EXPENSES:</b>   |                                     |               |
| Salaries and benefits   | 8,506                               | 7,572         |
| Net occupancy expense   | 2,212                               | 1,764         |
| Amortization of core deposit intangible   | 347                                 | 259           |
| Data processing   | 1,022                               | 1,095         |
| State and local taxes   | 595                                 | 474           |
| Legal, professional, and examination fees   | 464                                 | 438           |
| Advertising   | 427                                 | 414           |

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|  |                 |                 |
|--|-----------------|-----------------|
| FDIC insurance premiums  | 387             | 338             |
| Core processing conversion costs   | 42              | 0               |
| Merger costs   | 266             | 0               |
| Card processing and interchange expenses   | 587             | 579             |
| Other  | 2,241           | 2,073           |
| Total non-interest expenses  | 17,096          | 15,006          |
| <b>INCOME BEFORE INCOME TAXES</b>  | <b>8,686</b>    | <b>7,563</b>    |
| INCOME TAX EXPENSE (includes (\$28) and (\$7) income tax expense from reclassification items in 2016 and 2015, respectively) | 2,270           | 2,041           |
| <b>NET INCOME</b>  | <b>\$ 6,416</b> | <b>\$ 5,522</b> |
| <b>EARNINGS PER SHARE:</b>   |                 |                 |
| Basic  | \$ 0.44         | \$ 0.38         |
| Diluted  | \$ 0.44         | \$ 0.38         |
| <b>DIVIDENDS PER SHARE:</b>  |                 |                 |
| Cash dividends per share   | \$ 0.165        | \$ 0.165        |

See Notes to Consolidated Financial Statements

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## CONSOLIDATED STATEMENTS OF INCOME (unaudited)

Dollars in thousands, except per share data

|  | Nine months ended<br>September 30, |               |
|--|------------------------------------|---------------|
|  | 2016                               | 2015          |
| <b>INTEREST AND DIVIDEND INCOME:</b>   |                                    |               |
| Loans including fees   | \$ 59,478                          | \$ 53,294     |
| <b>Securities:</b>   |                                    |               |
| Taxable  | 7,026                              | 8,542         |
| Tax-exempt   | 2,575                              | 2,859         |
| Dividends  | 418                                | 489           |
| <b>Total interest and dividend income</b>  | <b>69,497</b>                      | <b>65,184</b> |
| <b>INTEREST EXPENSE:</b>   |                                    |               |
| Deposits   | 6,288                              | 6,381         |
| Borrowed funds   | 2,341                              | 2,464         |
| Subordinated debentures (includes \$260 and \$284 accumulated other comprehensive income reclassification for change in fair value of interest rate swap agreements in 2016 and 2015, respectively)                              | 590                                | 560           |
| <b>Total interest expense</b>  | <b>9,219</b>                       | <b>9,405</b>  |
| <b>NET INTEREST INCOME</b>   | <b>60,278</b>                      | <b>55,779</b> |
| <b>PROVISION FOR LOAN LOSSES</b>   | <b>2,038</b>                       | <b>1,892</b>  |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>   | <b>58,240</b>                      | <b>53,887</b> |
| <b>NON-INTEREST INCOME:</b>  |                                    |               |
| Wealth and asset management fees   | 2,298                              | 2,228         |
| Service charges on deposit accounts  | 3,149                              | 3,282         |
| Other service charges and fees   | 1,837                              | 2,223         |
| Net realized gains on available-for-sale securities (includes \$1,005 and \$564 accumulated other comprehensive income reclassifications for net realized gains on available-for-sale securities in 2016 and 2015, respectively) | 1,005                              | 564           |
| Net realized and unrealized gains (losses) on trading securities   | 265                                | (321)         |
| Mortgage banking   | 706                                | 484           |
| Bank owned life insurance  | 807                                | 853           |
| Card processing and interchange income   | 2,499                              | 2,542         |
| Other  | 501                                | 523           |
| <b>Total non-interest income</b>   | <b>13,067</b>                      | <b>12,378</b> |
| <b>NON-INTEREST EXPENSES:</b>  |                                    |               |
| Salaries and benefits  | 23,905                             | 21,710        |
| Net occupancy expense  | 5,932                              | 5,357         |
| Amortization of core deposit intangible  | 779                                | 777           |
| Data processing  | 3,395                              | 3,223         |
| State and local taxes  | 1,645                              | 1,498         |
| Legal, professional, and examination fees  | 1,202                              | 1,088         |
| Advertising  | 1,306                              | 1,167         |

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|   |                  |                  |
|---|------------------|------------------|
| FDIC insurance premiums   | 1,049            | 957              |
| Prepayment penalties long-term borrowings   | 1,506            | 0                |
| Core processing conversion costs  | 1,597            | 0                |
| Merger costs  | 481              | 0                |
| Card processing and interchange income  | 1,670            | 1,725            |
| Other   | 6,196            | 5,864            |
| <b>Total non-interest expenses</b>  | <b>50,663</b>    | <b>43,366</b>    |
| <b>INCOME BEFORE INCOME TAXES</b>   | <b>20,644</b>    | <b>22,899</b>    |
| <b>INCOME TAX EXPENSE</b> (includes \$262 and \$98 income tax expense from reclassification items in 2016 and 2015, respectively) | <b>5,144</b>     | <b>6,210</b>     |
| <b>NET INCOME</b>   | <b>\$ 15,500</b> | <b>\$ 16,689</b> |
| <b>EARNINGS PER SHARE:</b>  |                  |                  |
| Basic   | \$ 1.07          | \$ 1.16          |
| Diluted   | \$ 1.07          | \$ 1.16          |
| <b>DIVIDENDS PER SHARE:</b>   |                  |                  |
| Cash dividends per share  | \$ 0.495         | \$ 0.495         |

See Notes to Consolidated Financial Statements

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## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

Dollars in thousands

|  | Three months ended<br>September 30, |          | Nine months ended<br>September 30, |           |
|--|-------------------------------------|----------|------------------------------------|-----------|
|  | 2016                                | 2015     | 2016                               | 2015      |
| <b>NET INCOME</b>  | \$ 6,416                            | \$ 5,522 | \$ 15,500                          | \$ 16,689 |
| Other comprehensive income, net of tax:  |                                     |          |                                    |           |
| Net change in fair value of interest rate swap agreements designated as cash flow hedges:  |                                     |          |                                    |           |
| Unrealized gain (loss) on interest rate swaps, net of tax of (\$17) and \$44 for the three months ended September 30, 2016 and 2015, and \$42 and \$86 for the nine months ended September 30, 2016 and 2015                       | 32                                  | (81)     | (77)                               | (160)     |
| Reclassification adjustment for losses recognized in earnings, net of tax of (\$29) and (\$33) for the three months ended September 30, 2016 and 2015, and (\$91) and (\$99) for the nine months ended September 30, 2016 and 2015 | 55                                  | 62       | 169                                | 185       |
|  | 87                                  | (19)     | 92                                 | 25        |
| Net change in unrealized gains on securities available for sale:   |                                     |          |                                    |           |
| Unrealized gains (losses) on other-than-temporarily impaired securities available for sale:  |                                     |          |                                    |           |
| Unrealized gains (losses) arising during the period, net of tax of \$0 and \$0 for the three months ended September 30, 2016 and 2015, and \$276 and (\$90) for the nine months ended September 30, 2016 and 2015                  | 0                                   | 0        | (513)                              | 165       |
| Reclassification adjustment for realized gains included in net income, net of tax of \$0 and \$0 for the three months ended September 30, 2016 and 2015, and \$323 and \$0 for the nine months ended September 30, 2016 and 2015   | 0                                   | 0        | (599)                              |           |
|  | 0                                   | 0        | (1,112)                            | 165       |
| Unrealized gains on other securities available for sale:   |                                     |          |                                    |           |
| Unrealized gains arising during the period, net of tax of (\$103) and (\$2,059) for the three months ended September 30, 2016 and 2015, and (\$3,039) and (\$1,221) for the nine months ended September 30, 2016 and 2015          | 187                                 | 3,822    | 5,641                              | 2,268     |
| Reclassification adjustment for realized gains included in net income, net of tax of \$0 and \$26 for the three months ended September 30, 2016 and 2015, and \$29 and \$197 for the nine months ended September 30, 2016 and 2015 | 0                                   | (47)     | (54)                               | (367)     |
|  | 187                                 | 3,775    | 5,587                              | 1,901     |
| Other comprehensive income   | 274                                 | 3,756    | 4,567                              | 2,091     |
| <b>COMPREHENSIVE INCOME</b>  | \$ 6,690                            | \$ 9,278 | \$ 20,067                          | \$ 18,780 |

See Notes to Consolidated Financial Statements



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## CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

Dollars in thousands

|   | Nine months ended<br>September 30, |                 |
|---|------------------------------------|-----------------|
|   | 2016                               | 2015            |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                                    |                 |
| Net income  | \$ 15,500                          | \$ 16,689       |
| Adjustments to reconcile net income to net cash provided by operations:   |                                    |                 |
| Provision for loan losses   | 2,038                              | 1,892           |
| Depreciation and amortization of premises and equipment, core deposit intangible, and mortgage servicing rights   | 3,246                              | 3,051           |
| Amortization and accretion of securities premiums and discounts, deferred loan fees and costs, net yield and credit mark on acquired loans, and unearned income | (1,051)                            | 202             |
| Net realized gains on sales of available-for-sale securities  | (1,005)                            | (564)           |
| Net realized and unrealized losses (gains) on trading securities  | (265)                              | 321             |
| Proceeds from sale of trading securities  | 468                                | 618             |
| Purchase of trading securities  | (271)                              | (923)           |
| Gain on sale of loans   | (516)                              | (402)           |
| Net losses on dispositions of premises and equipment and foreclosed assets  | 117                                | 16              |
| Proceeds from sale of loans   | 22,329                             | 11,222          |
| Origination of loans held for sale  | (23,335)                           | (10,704)        |
| Income on bank owned life insurance   | (807)                              | (853)           |
| Stock-based compensation expense  | 628                                | 474             |
| Contribution of treasury stock  | 106                                | 84              |
| Changes in:   |                                    |                 |
| Accrued interest receivable and other assets  | (31,192)                           | 898             |
| Accrued interest payable and other liabilities  | (7,085)                            | 3,097           |
| <b>NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>  | <b>(21,095)</b>                    | <b>25,118</b>   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                                    |                 |
| Proceeds from maturities, prepayments and calls of available-for-sale securities  | 44,360                             | 59,935          |
| Proceeds from sales of available-for-sale securities  | 4,420                              | 86,554          |
| Purchase of available-for-sale securities   | (2,221)                            | (46,542)        |
| Net cash paid for Lake National Bank acquisition  | (2,866)                            | 0               |
| Loan origination and payments, net  | (102,014)                          | (161,300)       |
| Purchase of FHLB and other equity interests   | (1,776)                            | (6,743)         |
| Purchase of premises and equipment  | (6,082)                            | (5,182)         |
| Proceeds from the sale of premises and equipment and foreclosed assets  | 466                                | 708             |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>  | <b>(65,713)</b>                    | <b>(72,570)</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                                    |                 |
| Net change in:  |                                    |                 |
| Checking, money market and savings accounts   | 70,678                             | (19,375)        |
| Certificates of deposit   | (1,733)                            | 19,988          |
| Purchase of treasury stock  | (23)                               | (868)           |
| Cash dividends paid   | (7,158)                            | (7,138)         |
| Repayment of long-term borrowings   | (55,041)                           | (189)           |
| Proceeds from long-term borrowings  | 80,000                             | 0               |

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|  |                  |                  |
|--|------------------|------------------|
| Proceeds from issuance of subordinated debentures                                | 50,000           | 0                |
| Net change in short-term borrowings  | (40,272)         | 54,524           |
| <b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>                                 | <b>96,451</b>    | <b>46,942</b>    |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>                      | <b>9,643</b>     | <b>(510)</b>     |
| CASH AND CASH EQUIVALENTS, Beginning   | 27,261           | 27,928           |
| <b>CASH AND CASH EQUIVALENTS, Ending</b>   | <b>\$ 36,904</b> | <b>\$ 27,418</b> |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>                         |                  |                  |
| Cash paid during the period for:   |                  |                  |
| Interest   | \$ 9,506         | \$ 9,291         |
| Income taxes   | \$ 3,966         | \$ 5,431         |
| <b>SUPPLEMENTAL NONCASH DISCLOSURES:</b>   |                  |                  |
| Transfers to other real estate owned   | \$ 49            | \$ 484           |
| Grant of restricted stock awards from treasury stock                             | \$ 875           | \$ 821           |
| Net assets acquired from Lake National Bank, excluding cash and cash equivalents | \$ 2,866         | 0                |

See Notes to Consolidated Financial Statements

**Table of Contents****CNB FINANCIAL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(UNAUDITED)****1. BASIS OF PRESENTATION**

The accompanying consolidated financial statements have been prepared pursuant to rules and regulations of the SEC and in compliance with accounting principles generally accepted in the United States of America ( GAAP ). Because this report is based on an interim period, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted.

In the opinion of management of the registrant, the accompanying consolidated financial statements as of September 30, 2016 and for the three and nine month periods ended September 30, 2016 and 2015 include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial condition and the results of operations for the periods presented. The financial performance reported for CNB Financial Corporation (the Corporation ) for the three and nine month periods ended September 30, 2016 is not necessarily indicative of the results to be expected for the full year. This information should be read in conjunction with the Corporation s Annual Report on Form 10-K for the period ended December 31, 2015. All dollar amounts are stated in thousands, except share and per share data and other amounts as indicated. Certain prior period amounts have been reclassified to conform to the current period presentation.

**2. BUSINESS COMBINATION**

On July 15, 2016, the Corporation completed its previously announced acquisition of Lake National Bank ( LNB ) of Mentor, Ohio for \$22.50 per share in cash, resulting in consideration paid to LNB shareholders of \$24.75 million. Following completion of the merger, the two branches of LNB in Mentor, Ohio are operating as part of the ERIEBANK division of CNB Bank.

As disclosed in the accompanying consolidated statements of income, the Corporation incurred merger costs of \$266 thousand and \$481 thousand for the three and nine months ended September 30, 2016. All merger costs have been expensed as incurred.

The following table summarizes the consideration paid for LNB and the amounts of the assets acquired and liabilities assumed that were recognized at the acquisition date:

|  |           |
|--|-----------|
| <b>Consideration paid:</b>   |           |
| Cash   | \$ 24,750 |
| <b>Recognized amounts of identifiable assets acquired and liabilities assumed:</b> |           |
| Cash and cash equivalents  | 21,884    |
| Securities available for sale  | 450       |
| Loans  | 122,036   |
| FHLB and other equity interests  | 637       |
| Premises and equipment   | 3,242     |
| Bank owned life insurance  | 2,152     |
| Mortgage servicing rights  | 109       |
| Core deposit intangible  | 1,583     |
| Accrued interest receivable and other assets                                       | 3,301     |

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|  |           |
|--|-----------|
| Total assets acquired                          | 155,394   |
| Demand deposits                                | 81,472    |
| Time deposits                                  | 58,311    |
| Accrued interest payable and other liabilities | 2,634     |
| Total liabilities assumed                      | 142,417   |
| Total identifiable net assets                  | 12,977    |
| Goodwill                                       | \$ 11,773 |

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Valuation of some assets acquired or created including, but not limited to, goodwill are preliminary and could be subject to change.

Included in accrued interest receivable and other assets is a deferred tax asset of \$249 which represents the tax effect of temporary differences between the tax basis and fair values assigned to the assets and liabilities.

Acquired loans were recorded at fair value with no carryover of the related allowance for loan losses. Determining the fair value of loans involved estimating the amount and timing of principal and interest cash flows expected to be collected on the loans and discounting those cash flows at a market rate of interest. The Corporation acquired \$126,134 of gross loans and recognized a net combined yield and credit mark of \$4,098.

Goodwill of \$11,773 arising from the acquisition consisted largely of synergies and the cost savings resulting from the combining of the operations of the Corporation and Lake National Bank. None of the goodwill is expected to be deductible for income tax purposes.

**3. STOCK COMPENSATION**

The Corporation has a stock incentive plan for key employees and independent directors. The stock incentive plan, which is administered by a committee of the Board of Directors, provides for aggregate grants of up to 500,000 shares of common stock in the form of nonqualified options or restricted stock. For key employees, the plan vesting is one-fourth of the granted options or restricted stock per year beginning one year after the grant date, with 100% vested on the fourth anniversary of the grant date. For independent directors, the vesting schedule is one-third of the granted options or restricted stock per year beginning one year after the grant date, with 100% vested on the third anniversary of the grant date.

At September 30, 2016, there was no unrecognized compensation cost related to nonvested stock options granted under this plan and no stock options were granted during the three and nine month periods ended September 30, 2016 and 2015.

Compensation expense for the restricted stock awards is recognized over the requisite service period noted above based on the fair value of the shares at the date of grant. Nonvested restricted stock awards are recorded as a reduction of additional paid-in-capital in shareholders' equity until earned. Compensation expense resulting from these restricted stock awards was \$216 and \$628 for the three and nine months ended September 30, 2016 and \$169 and \$474 for the three and nine months ended September 30, 2015. As of September 30, 2016, there was \$1,359 of total unrecognized compensation cost related to unvested restricted stock awards to be recognized over the next five years.

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A summary of changes in nonvested restricted stock awards for the three months ended September 30, 2016 follows:

|                                  | Shares  | Per Share<br>Weighted<br>Average<br>Grant Date<br>Fair Value |
|----------------------------------|---------|--|
| Nonvested at beginning of period | 103,228 | \$ 17.35   |
| Granted                          | 750     | 18.40  |
| Vested                           | (150)   | 17.80  |
| Nonvested at end of period       | 103,828 | \$ 17.35   |

A summary of changes in nonvested restricted stock awards for the nine months ended September 30, 2016 follows:

|                                  | Shares   | Per Share<br>Weighted<br>Average<br>Grant Date<br>Fair Value |
|----------------------------------|----------|--|
| Nonvested at beginning of period | 84,600   | \$ 17.01   |
| Granted                          | 52,250   | 17.65  |
| Vested                           | (33,022) | 16.92  |
| Nonvested at end of period       | 103,828  | \$ 17.35   |

The fair value of shares vested was \$3 and \$559 during the three and nine month periods ended September 30, 2016.

**4. FAIR VALUE****Fair Value Measurement**

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A fair value hierarchy has also been established which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following three levels of inputs are used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

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

The fair values of most trading securities and securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities

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without relying exclusively on quoted prices for the specific securities but rather relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

The Corporation's structured pooled trust preferred securities are priced using Level 3 inputs. The decline in the level of observable inputs and market activity in this class of investments by the measurement date has been significant and resulted in unreliable external pricing. Broker pricing and bid/ask spreads, when available, vary widely, and the once-active market has become comparatively inactive. The Corporation engaged a third party consultant who has developed a model for pricing these securities. Information such as historical and current performance of the underlying collateral, deferral and default rates, collateral coverage ratios, break in yield calculations, cash flow projections, liquidity and credit premiums required by a

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market participant, and financial trend analysis with respect to the individual issuing financial institutions and insurance companies are utilized in determining the security valuation. Due to the current market conditions as well as the limited trading activity of these types of securities, the market value of the Corporation's structured pooled trust preferred securities are highly sensitive to assumption changes and market volatility.

The Corporation's derivative instruments are interest rate swaps that are similar to those that trade in liquid markets. As such, significant fair value inputs can generally be verified and do not typically involve significant management judgments (Level 2 inputs).

Assets and liabilities measured at fair value on a recurring basis are as follows at September 30, 2016 and December 31, 2015:

| Description                                | Total             | Fair Value Measurements at September 30, 2016 Using                        |   |  |
|--|-------------------|--|---|--|
|  |                   | Quoted Prices in<br>Active Markets for<br>Identical<br>Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Assets:</b>                             |                   |  |   |  |
| <b>Securities Available For Sale:</b>      |                   |  |   |  |
| U.S. Government sponsored entities         | \$ 139,902        | \$ 0   | \$ 139,902  | \$ 0   |
| States and political subdivisions          | 161,210           | 0  | 161,210   | 0  |
| Residential and multi-family mortgage      | 139,022           | 0  | 139,022   | 0  |
| Corporate notes and bonds                  | 17,279            | 0  | 17,279  | 0  |
| Pooled trust preferred                     | 1,702             | 0  | 0   | 1,702  |
| Pooled SBA                                 | 46,635            | 0  | 46,635  | 0  |
| Other equity securities                    | 994               | 994  | 0   | 0  |
| <b>Total Securities Available For Sale</b> | <b>\$ 506,744</b> | <b>\$ 994</b>  | <b>\$ 504,048</b>                                   | <b>\$ 1,702</b>                                    |
| Interest rate swaps                        | \$ 766            | \$ 0   | \$ 766  | \$ 0   |
| <b>Trading Securities:</b>                 |                   |  |   |  |
| Corporate equity securities                | \$ 3,148          | \$ 3,148   | \$ 0  | \$ 0   |
| Mutual funds                               | 964               | 964  | 0   | 0  |
| Certificates of deposit                    | 255               | 255  | 0   | 0  |
| Corporate notes and bonds                  | 221               | 221  | 0   | 0  |
| U.S. Government sponsored entities         | 55                | 0  | 55  | 0  |
| <b>Total Trading Securities</b>            | <b>\$ 4,644</b>   | <b>\$ 4,589</b>  | <b>\$ 55</b>  | <b>\$ 0</b>  |
| <b>Liabilities,</b>                        |                   |  |   |  |
| Interest rate swaps                        | \$ (1,361)        | \$ 0   | \$ (1,361)  | \$ 0   |

| Description                           | Total      | Fair Value Measurements at December 31, 2015 Using                            |   |  |
|---------------------------------------|------------|---|---|--|
|                                       |            | Quoted Prices<br>in<br>Active Markets for<br>Identical<br>Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Assets:</b>                        |            |   |   |  |
| <b>Securities Available For Sale:</b> |            |   |   |  |
| U.S. Government sponsored entities    | \$ 141,751 | \$ 0  | \$ 141,751  | \$ 0   |
| States and political subdivisions     | 171,819    | 0   | 171,819   | 0  |
| Residential and multi-family mortgage | 157,982    | 0   | 157,982   | 0  |

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|                                     |            |          |            |          |
|-------------------------------------|------------|----------|------------|----------|
| Corporate notes and bonds           | 18,688     | 0        | 18,688     | 0        |
| Pooled trust preferred              | 3,413      | 0        | 0          | 3,413    |
| Pooled SBA                          | 51,409     | 0        | 51,409     | 0        |
| Other equity securities             | 981        | 981      | 0          | 0        |
| <br>                                |            |          |            |          |
| Total Securities Available For Sale | \$ 546,043 | \$ 981   | \$ 541,649 | \$ 3,413 |
| <br>                                |            |          |            |          |
| Interest rate swaps                 | \$ 131     | \$ 0     | \$ 131     | \$ 0     |
| <br>                                |            |          |            |          |
| Trading Securities:                 |            |          |            |          |
| Corporate equity securities         | \$ 3,389   | \$ 3,389 | \$ 0       | \$ 0     |
| Mutual funds                        | 750        | 750      | 0          | 0        |
| Certificates of deposit             | 253        | 253      | 0          | 0        |
| Corporate notes and bonds           | 130        | 130      | 0          | 0        |
| U.S. Government sponsored entities  | 54         | 0        | 54         | 0        |
| <br>                                |            |          |            |          |
| Total Trading Securities            | \$ 4,576   | \$ 4,522 | \$ 54      | \$ 0     |
| <br>                                |            |          |            |          |
| Liabilities,                        |            |          |            |          |
| Interest rate swaps                 | \$ (867)   | \$ 0     | \$ (867)   | \$ 0     |

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The table below presents a reconciliation of the fair value of securities available for sale measured on a recurring basis using significant unobservable inputs (Level 3) for the three months ended September 30, 2016 and September 30, 2015:

|   | 2016            | 2015            |
|---|-----------------|-----------------|
| Balance, July 1                                     | \$ 1,702        | \$ 1,160        |
| Proceeds from sale of securities                    | 0               | 0               |
| Total gains or (losses):                            |                 |                 |
| Included in other comprehensive income (unrealized) | 0               | 0               |
| <b>Balance, September 30</b>                        | <b>\$ 1,702</b> | <b>\$ 1,160</b> |

The table below presents a reconciliation of the fair value of securities available for sale measured on a recurring basis using significant unobservable inputs (Level 3) for the nine months ended September 30, 2016 and September 30, 2015:

|   | 2016            | 2015            |
|---|-----------------|-----------------|
| Balance, January 1                                  | \$ 3,413        | \$ 905          |
| Proceeds from sale of securities                    | (922)           | 0               |
| Total gains or (losses):                            |                 |                 |
| Included in other comprehensive income (unrealized) | (789)           | 255             |
| <b>Balance, September 30</b>                        | <b>\$ 1,702</b> | <b>\$ 1,160</b> |

The following table presents quantitative information about Level 3 fair value measurements at September 30, 2016:

|                        | Fair value | Valuation Technique  | Unobservable Inputs      | Input Utilized                                       |
|------------------------|------------|----------------------|--------------------------|--|
| Pooled trust preferred | \$ 1,702   | Discounted cash flow | Collateral default rate  | 0.5% in 2016 and thereafter                          |
|                        |            |                      | Yield (weighted average) | 10.0%  |
|                        |            |                      | Prepayment speed         | 2.0% constant prepayment rate in 2016 and thereafter |

The following table presents quantitative information about Level 3 fair value measurements at December 31, 2015:

|                        | Fair value | Valuation Technique  | Unobservable Inputs      | Input Utilized                                       |
|------------------------|------------|----------------------|--------------------------|--|
| Pooled trust preferred | \$ 3,413   | Discounted cash flow | Collateral default rate  | 1% in 2015; 0.5% in 2016 and thereafter              |
|                        |            |                      | Yield (weighted average) | 9.0%   |
|                        |            |                      | Prepayment speed         | 2.0% constant prepayment rate in 2015 and thereafter |



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At September 30, 2016 and December 31, 2015, the significant unobservable inputs used in the fair value measurement of the Corporation's pooled trust preferred securities are collateral default rate, yield, and prepayment speed. Significant increases in specific-issuer default assumptions or decreases in specific-issuer recovery assumptions would result in a lower fair value measurement. Conversely, decreases in specific-issuer default assumptions or increases in specific-issuer recovery assumptions would result in a higher fair value measurement.

Assets and liabilities measured at fair value on a non-recurring basis are as follows at September 30, 2016 and December 31, 2015:

| Description            | Total    | Fair Value Measurements at September 30, 2016 Using Quoted Prices in Active Markets for Identical Assets (Level 1) |   |         |
|------------------------|----------|--|---|---------|
|                        |          | Significant Other Observable Inputs (Level 2)  | Significant Unobservable Inputs (Level 3) |         |
| <b>Assets:</b>         |          |  |   |         |
| <b>Impaired loans:</b> |          |  |   |         |
| Commercial mortgages   | \$ 2,002 | 0  | 0   | \$2,002 |

| Description            | Total    | Fair Value Measurements at December 31, 2015 Using Quoted Prices in Active Markets for Identical Assets (Level 1) |   |         |
|------------------------|----------|---|---|---------|
|                        |          | Significant Other Observable Inputs (Level 2)   | Significant Unobservable Inputs (Level 3) |         |
| <b>Assets:</b>         |          |   |   |         |
| <b>Impaired loans:</b> |          |   |   |         |
| Commercial mortgages   | \$ 2,247 | 0   | 0   | \$2,247 |

Impaired loans, measured for impairment using the fair value of collateral for collateral dependent loans, had a recorded investment of \$3,202 with a valuation allowance of \$1,200 as of September 30, 2016, resulting in an additional negative provision for loan losses of \$(95) and \$(42) for the corresponding three and nine month period ended September 30, 2016. Impaired loans had a recorded investment of \$3,489 with a valuation allowance of \$1,242 as of December 31, 2015. Impaired loans carried at fair value resulted in an additional provision for loan losses of \$(361) and \$(298) for the corresponding three and nine month period ended September 30, 2015.

The estimated fair values of impaired collateral dependent loans such as commercial or residential mortgages are determined primarily through third-party appraisals. When a collateral dependent loan, such as a commercial or residential mortgage loan, becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal, and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral and a further reduction for estimated costs to sell the property is applied, which results in an amount that is considered to be the estimated fair value. If a loan becomes impaired and the appraisal of related loan collateral is outdated, management applies an appropriate adjustment factor based on its experience with current valuations of similar collateral in determining the loan's estimated fair value and resulting allowance for loan losses. Third-party appraisals are not customarily obtained in respect of unimpaired loans, unless in management's view changes in circumstances warrant obtaining an updated appraisal.

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The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at September 30, 2016:

|                |            | Fair value | Valuation Technique       | Unobservable Inputs                                     | Range (Weighted Average) |
|----------------|------------|------------|---------------------------|---|--------------------------|
| Impaired loans | commercial | \$2,002    | Sales comparison approach | Adjustment for differences between the comparable sales | 19% - 99% (37%)          |
| mortgages      |            |            |                           |   |                          |

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2015:

|                |            | Fair value | Valuation Technique       | Unobservable Inputs                                     | Range (Weighted Average) |
|----------------|------------|------------|---------------------------|---|--------------------------|
| Impaired loans | commercial | \$2,247    | Sales comparison approach | Adjustment for differences between the comparable sales | 25% - 69% (36%)          |
| mortgages      |            |            |                           |   |                          |

**Fair Value of Financial Instruments**

The following table presents the carrying amount and fair value of financial instruments at September 30, 2016:

|                                 | Carrying Amount | Fair Value Measurement Using: |              |           | Total Fair Value |
|---------------------------------|-----------------|-------------------------------|--------------|-----------|------------------|
|                                 |                 | Level 1                       | Level 2      | Level 3   |                  |
| <b>ASSETS</b>                   |                 |                               |              |           |                  |
| Cash and cash equivalents       | \$ 36,904       | \$ 36,904                     | \$ 0         | \$ 0      | \$ 36,904        |
| Securities available for sale   | 506,744         | 994                           | 504,048      | 1,702     | 506,744          |
| Trading securities              | 4,644           | 4,589                         | 55           | 0         | 4,644            |
| Loans held for sale             | 2,814           | 0                             | 2,829        | 0         | 2,829            |
| Net loans                       | 1,785,155       | 0                             | 0            | 1,783,814 | 1,783,814        |
| FHLB and other equity interests | 18,334          | n/a                           | n/a          | n/a       | n/a              |
| Interest rate swaps             | 766             | 0                             | 766          | 0         | 766              |
| Accrued interest receivable     | 8,387           | 6                             | 3,105        | 5,276     | 8,387            |
| <b>LIABILITIES</b>              |                 |                               |              |           |                  |
| Deposits                        | \$ (2,023,781)  | \$ (1,783,037)                | \$ (240,275) | \$ 0      | \$ (2,023,312)   |
| FHLB and other borrowings       | (205,202)       | 0                             | (204,314)    | 0         | (204,314)        |
| Subordinated debentures         | (70,620)        | 0                             | (61,432)     | 0         | (61,432)         |
| Interest rate swaps             | (1,361)         | 0                             | (1,361)      | 0         | (1,361)          |
| Accrued interest payable        | (479)           | 0                             | (479)        | 0         | (479)            |

The following table presents the carrying amount and fair value of financial instruments at December 31, 2015:

|                               | Carrying Amount | Fair Value Measurement Using: |         |         | Total Fair Value |
|-------------------------------|-----------------|-------------------------------|---------|---------|------------------|
|                               |                 | Level 1                       | Level 2 | Level 3 |                  |
| <b>ASSETS</b>                 |                 |                               |         |         |                  |
| Cash and cash equivalents     | \$ 27,261       | \$ 27,261                     | \$ 0    | \$ 0    | \$ 27,261        |
| Securities available for sale | 546,043         | 981                           | 541,649 | 3,413   | 546,043          |

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|                                 |                |                |              |           |             |
|---------------------------------|----------------|----------------|--------------|-----------|-------------|
| Trading securities              | 4,576          | 4,522          | 54           | 0         | 4,576       |
| Loans held for sale             | 1,381          | 0              | 1,438        | 0         | 1,438       |
| Net loans                       | 1,561,061      | 0              | 0            | 1,554,502 | 1,554,502   |
| FHLB and other equity interests | 15,921         | n/a            | n/a          | n/a       | n/a         |
| Interest rate swaps             | 131            | 0              | 131          | 0         | 131         |
| Accrued interest receivable     | 7,312          | 5              | 2,875        | 4,432     | 7,312       |
| <b>LIABILITIES</b>              |                |                |              |           |             |
| Deposits                        | \$ (1,815,053) | \$ (1,630,888) | \$ (183,028) | \$ 0      | (1,813,916) |
| FHLB and other borrowings       | (220,515)      | 0              | (218,808)    | 0         | (218,808)   |
| Subordinated debentures         | (20,620)       | 0              | (11,761)     | 0         | (11,761)    |
| Interest rate swaps             | (867)          | 0              | (867)        | 0         | (867)       |
| Accrued interest payable        | (766)          | (344)          | (422)        | 0         | (766)       |

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The methods and assumptions, not otherwise presented, used to estimate fair values are described as follows:

**Cash and cash equivalents:** The carrying amounts of cash and cash equivalents approximate fair values and are classified as Level 1.

**Loans held for sale:** The fair value of loans held for sale is estimated based upon binding contracts and quotes from third party investors resulting in a Level 2 classification.

**Loans:** For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values, resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality, resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described previously. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

**FHLB and other equity interests:** It is not practical to determine the fair value of Federal Home Loan Bank stock and other equity interests due to restrictions placed on the transferability of these instruments.

**Accrued interest receivable:** The carrying amount of accrued interest receivable approximates fair value. The Level classification of accrued interest receivable is matched to the corresponding Level of the asset with which it is associated.

**Deposits:** The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount), resulting in a Level 1 classification. Fair values for time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits, resulting in a Level 2 classification.

**FHLB and other borrowings:** The fair values of the Corporation's FHLB and other borrowings are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements, resulting in a Level 2 classification.

**Subordinated debentures:** The fair value of the Corporation's subordinated debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of arrangements, resulting in a Level 2 classification.

**Accrued interest payable:** The carrying amount of accrued interest payable approximates fair value resulting in a classification that is consistent with the liability with which it is associated.

While estimates of fair value are based on management's judgment of the most appropriate factors as of the balance sheet date, there is no assurance that the estimated fair values would have been realized if the assets had been disposed of or the liabilities settled at that date, since market values may differ depending on various circumstances. The estimated fair values would also not apply to subsequent dates.

In addition, other assets and liabilities that are not financial instruments, such as premises and equipment, are not included in the disclosures. Also, non-financial assets such as, among other things, the estimated earning power of core deposits, the earnings potential of trust accounts, the trained workforce, and customer goodwill, which typically are not recognized on the balance sheet, may have value but are not included in the fair value disclosures.

**Table of Contents****5. SECURITIES**

Securities available for sale at September 30, 2016 and December 31, 2015 are as follows:

|                                     | September 30, 2016 |                     |                      |                   | December 31, 2015 |                     |                      |                   |
|-------------------------------------|--------------------|---------------------|----------------------|-------------------|-------------------|---------------------|----------------------|-------------------|
|                                     | Amortized<br>Cost  | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value     | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value     |
| U.S. Gov t sponsored entities       | \$ 136,945         | \$ 2,958            | \$ (1)               | \$ 139,902        | \$ 141,300        | \$ 1,579            | \$ (1,128)           | \$ 141,751        |
| State & political subdivisions      | 153,762            | 7,643               | (195)                | 161,210           | 165,828           | 6,234               | (243)                | 171,819           |
| Residential & multi-family mortgage | 137,639            | 1,894               | (511)                | 139,022           | 160,316           | 1,060               | (3,394)              | 157,982           |
| Corporate notes & bonds             | 18,299             | 177                 | (1,197)              | 17,279            | 19,794            | 165                 | (1,271)              | 18,688            |
| Pooled trust preferred              | 800                | 902                 | 0                    | 1,702             | 800               | 2,613               | 0                    | 3,413             |
| Pooled SBA                          | 45,964             | 793                 | (122)                | 46,635            | 51,556            | 760                 | (907)                | 51,409            |
| Other equity securities             | 1,020              | 0                   | (26)                 | 994               | 1,020             | 0                   | (39)                 | 981               |
| <b>Total</b>                        | <b>\$ 494,429</b>  | <b>\$ 14,367</b>    | <b>\$ (2,052)</b>    | <b>\$ 506,744</b> | <b>\$ 540,614</b> | <b>\$ 12,411</b>    | <b>\$ (6,982)</b>    | <b>\$ 546,043</b> |

At September 30, 2016 and December 31, 2015, there were no holdings of securities of any one issuer, other than the U.S. Government sponsored entities, in an amount greater than 10% of shareholders' equity. The Corporation's residential and multi-family mortgage securities are issued by government sponsored entities.

Trading securities at September 30, 2016 and December 31, 2015 are as follows:

|                                    | September 30,<br>2016 | December 31,<br>2015 |
|------------------------------------|-----------------------|----------------------|
| Corporate equity securities        | \$ 3,148              | \$ 3,389             |
| Mutual funds                       | 965                   | 750                  |
| Certificates of deposit            | 255                   | 253                  |
| Corporate notes and bonds          | 221                   | 130                  |
| U.S. Government sponsored entities | 55                    | 54                   |
| <b>Total</b>                       | <b>\$ 4,644</b>       | <b>\$ 4,576</b>      |

Securities with unrealized losses at September 30, 2016 and December 31, 2015, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows (in thousands):

**September 30, 2016**

| Description of Securities           | Less than 12 Months |                    | 12 Months or More |                    | Total            |                    |
|-------------------------------------|---------------------|--------------------|-------------------|--------------------|------------------|--------------------|
|                                     | Fair<br>Value       | Unrealized<br>Loss | Fair<br>Value     | Unrealized<br>Loss | Fair<br>Value    | Unrealized<br>Loss |
| U.S. Gov t sponsored entities       | \$ 0                | \$ 0               | \$ 3,001          | \$ (1)             | \$ 3,001         | \$ (1)             |
| State & political subdivisions      | 1,669               | (2)                | 272               | (193)              | 1,941            | (195)              |
| Residential & multi-family mortgage | 10,975              | (78)               | 40,280            | (433)              | 51,255           | (511)              |
| Corporate notes & bonds             | 1,977               | (23)               | 8,251             | (1,174)            | 10,228           | (1,197)            |
| Pooled SBA                          | 0                   | 0                  | 22,441            | (122)              | 22,441           | (122)              |
| Other equity securities             | 0                   | 0                  | 994               | (26)               | 994              | (26)               |
|                                     | <b>\$ 14,621</b>    | <b>\$ (103)</b>    | <b>\$ 75,239</b>  | <b>\$ (1,949)</b>  | <b>\$ 89,860</b> | <b>\$ (2,052)</b>  |



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December 31, 2015

| Description of Securities           | Less than 12 Months |                 | 12 Months or More |                 | Total      |                 |
|-------------------------------------|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
|                                     | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. Gov t sponsored entities       | \$ 65,675           | \$ (640)        | \$ 31,923         | \$ (488)        | \$ 97,598  | \$ (1,128)      |
| State & political subdivisions      | 9,103               | (234)           | 2,478             | (9)             | 11,581     | (243)           |
| Residential & multi-family mortgage | 69,631              | (1,562)         | 50,351            | (1,832)         | 119,982    | (3,394)         |
| Corporate notes & bonds             | 5,027               | (2)             | 8,144             | (1,269)         | 13,171     | (1,271)         |
| Pooled SBA                          | 2,908               | (28)            | 27,127            | (879)           | 30,035     | (907)           |
| Other equity securities             | 0                   | 0               | 981               | (39)            | 981        | (39)            |
|                                     | \$ 152,344          | \$ (2,466)      | \$ 121,004        | \$ (4,516)      | \$ 273,348 | \$ (6,982)      |

The Corporation evaluates securities for other-than-temporary impairment on a quarterly basis, or more frequently when economic or market conditions warrant such an evaluation.

A roll-forward of the other-than-temporary impairment amount related to credit losses for the three and nine months ended September 30, 2016 and 2015 is as follows:

|  | 2016     | 2015     |
|--|----------|----------|
| Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in earnings, beginning of period | \$ 4,054 | \$ 4,054 |
| Credit losses previously recognized on securities sold during the period   | (1,983)  | 0        |
| Additional credit loss for which other-than-temporary impairment was not previously recognized   | 0        | 0        |
| Additional credit loss for which other-than-temporary impairment was previously recognized   | 0        | 0        |
| Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in earnings, end of period       | \$ 2,071 | \$ 4,054 |

During the quarter ended June 30, 2016 the Corporation sold two structured pooled trust preferred securities which had been charged off in their entirety in prior periods. The original cost basis of these securities was \$1,983 and the proceeds received totaled \$922, which is reported in net realized gains on available-for-sale securities for the three and nine months ended September 30, 2016. Due to the insignificance of the Corporation's adjusted amortized cost balance of the remaining structured pooled trust securities, no further disclosures are required.

For the securities that comprise corporate notes and bonds and the securities that are issued by state and political subdivisions, management monitors publicly available financial information, such as filings with the Securities and Exchange Commission, in order to evaluate the securities for other-than-temporary impairment. For financial institution issuers, management monitors information from quarterly call report filings that are used to generate Uniform Bank Performance Reports. All other securities that were in an unrealized loss position at the balance sheet date were reviewed by management, and issuer-specific documents were reviewed, as appropriate given the following considerations. When reviewing securities for other-than-temporary impairment, management considers the financial condition and near-term prospects of the issuer and whether downgrades by bond rating agencies have occurred. Management also considers the length of time and extent to which fair value has been less than cost, and whether management does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery.

As of September 30, 2016 and December 31, 2015, management concluded that the securities described in the previous paragraph were not other-than-temporarily impaired for the following reasons:

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There is no indication of any significant deterioration of the creditworthiness of the institutions that issued the securities.

All contractual interest payments on the securities have been received as scheduled, and no information has come to management's attention through the processes previously described which would lead to a conclusion that future contractual payments will not be timely received.

The Corporation does not intend to sell and it is not more likely than not that it will be required to sell the securities in an unrealized loss position before recovery of its amortized cost basis.

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Information pertaining to security sales on available for sale securities is as follows:

|                                       | Proceeds | Gross Gains | Gross Losses |
|---------------------------------------|----------|-------------|--------------|
| Three months ended September 30, 2016 | \$ 0     | \$ 0        | \$ 0         |
| Nine months ended September 30, 2016  | 4,420    | 1,005       | 0            |
| Three months ended September 30, 2015 | 38,025   | 244         | (171)        |
| Nine months ended September 30, 2015  | 86,554   | 852         | (288)        |

The following is a schedule of the contractual maturity of securities available for sale, excluding equity securities, at September 30, 2016:

|                                       | Amortized<br>Cost | Fair<br>Value |
|---------------------------------------|-------------------|---------------|
| 1 year or less                        | \$ 41,920         | \$ 41,532     |
| 1 year 5 years                        | 179,919           | 186,380       |
| 5 years 10 years                      | 70,832            | 73,920        |
| After 10 years                        | 17,135            | 18,261        |
|                                       | 309,806           | 320,093       |
| Residential and multi-family mortgage | 137,639           | 139,022       |
| Pooled SBA                            | 45,964            | 46,635        |
| Total debt securities                 | \$ 493,409        | \$ 505,750    |

Mortgage and asset backed securities and pooled SBA securities are not due at a single date; periodic payments are received based on the payment patterns of the underlying collateral.

On September 30, 2016 and December 31, 2015, securities carried at \$347,196 and \$312,669, respectively, were pledged to secure public deposits and for other purposes as provided by law.

**6. LOANS**

Total net loans at September 30, 2016 and December 31, 2015 are summarized as follows:

|  | September 30,<br>2016 | December 31,<br>2015 |
|--|-----------------------|----------------------|
| Commercial, industrial, and agricultural | \$ 569,267            | \$ 475,364           |
| Commercial mortgages                     | 507,340               | 448,179              |
| Residential real estate                  | 644,545               | 574,225              |
| Consumer                                 | 77,405                | 78,345               |
| Credit cards                             | 5,842                 | 5,201                |
| Overdrafts                               | 73                    | 1,040                |
| Less: unearned discount                  | (3,614)               | (4,556)              |
| allowance for loan losses                | (15,703)              | (16,737)             |
| Loans, net                               | \$ 1,785,155          | \$ 1,561,061         |

At September 30, 2016 and December 31, 2015, net unamortized loan fees of \$(824) and \$(636), respectively, have been included in the carrying value of loans.

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The Bank attempts to limit concentrations within specific industries by utilizing dollar limitations to single industries or customers, and by entering into participation agreements with third parties. Collateral requirements are established based on management's assessment of the customer. The Corporation maintains lending policies to control the quality of the loan portfolio. These policies delegate the authority to extend loans under specific guidelines and underwriting standards. These policies are prepared by the Corporation's management and reviewed and ratified annually by the Corporation's Board of Directors.

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All relevant documentation, such as the loan application, financial statements and tax returns, required under the lending policies is summarized and provided to management and/or the Corporation's Board of Directors in connection with the loan approval process. Such documentation is subsequently electronically archived in the Corporation's document management system. Pursuant to the Corporation's lending policies, management considers a variety of factors when determining whether to extend credit to a customer, including loan-to-value ratios, FICO scores, quality of the borrower's financial statements, and the ability to obtain personal guarantees.

Commercial, industrial, and agricultural loans comprised 32% and 30% of the Corporation's total loan portfolio at September 30, 2016 and December 31, 2015. Commercial mortgage loans comprised 28% of the Corporation's total loan portfolio at September 30, 2016 and December 31, 2015. Management assigns a risk rating to all commercial loans at loan origination. The loan-to-value policy guidelines for commercial, industrial, and agricultural loans are generally a maximum of 80% of the value of business equipment, a maximum of 75% of the value of accounts receivable, and a maximum of 60% of the value of business inventory. The loan-to-value policy guideline for commercial mortgage loans is generally a maximum of 85% of the appraised value of the real estate.

Residential real estate loans comprised 36% of the Corporation's total loan portfolio at September 30, 2016 and December 31, 2015. The loan-to-value policy guidelines for residential real estate loans vary depending on the collateral position and the specific type of loan. Higher loan-to-value terms may be approved with the appropriate private mortgage insurance coverage. The Corporation also originates and prices loans for sale into the secondary market through Freddie Mac. Loans originated for sale into the secondary market are classified as loans held for sale and are excluded from residential real estate loans reported above. The rationale for these sales is to mitigate interest rate risk associated with holding lower rate, long-term residential mortgages in the loan portfolio and to generate fee revenue from sales and servicing the loan. The Corporation also offers a variety of unsecured and secured consumer loan and credit card products which represent less than 10% of the total loan portfolio at both September 30, 2016 and December 31, 2015. Terms and collateral requirements vary depending on the size and nature of the loan.

CNB has not underwritten any hybrid loans, payment option loans, or low documentation/no documentation loans. Variable rate loans are generally underwritten at the fully indexed rate. Loan underwriting policies and procedures have not changed materially between any periods presented.

Transactions in the allowance for loan losses for the three months ended September 30, 2016 were as follows:

|   | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total     |
|---|--|-------------------------|-------------------------------|----------|-----------------|------------|-----------|
| Allowance for loan losses, July 1, 2016       | \$ 5,218                                       | \$ 6,207                | \$ 2,299                      | \$ 2,066 | \$ 50           | \$ 148     | \$ 15,988 |
| Charge-offs                                   | (86)   | 0                       | (95)                          | (709)    | (17)            | (86)       | (993)     |
| Recoveries                                    | 37   | 2                       | 10                            | 20       | 3               | 14         | 86        |
| Provision (benefit) for loan losses           | (24)   | 27                      | (65)                          | 545      | 36              | 103        | 622       |
| Allowance for loan losses, September 30, 2016 | \$ 5,145                                       | \$ 6,236                | \$ 2,149                      | \$ 1,922 | \$ 72           | \$ 179     | \$ 15,703 |

Transactions in the allowance for loan losses for the nine months ended September 30, 2016 were as follows:

|   | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total     |
|---|--|-------------------------|-------------------------------|----------|-----------------|------------|-----------|
| Allowance for loan losses, January 1, 2016    | \$ 6,035                                       | \$ 5,605                | \$ 2,475                      | \$ 2,371 | \$ 90           | \$ 161     | \$ 16,737 |
| Charge-offs                                   | (519)  | (20)                    | (244)                         | (2,397)  | (54)            | (167)      | (3,401)   |
| Recoveries                                    | 84   | 7                       | 72                            | 94       | 18              | 54         | 329       |
| Provision (benefit) for loan losses           | (455)  | 644                     | (154)                         | 1,854    | 18              | 131        | 2,038     |
| Allowance for loan losses, September 30, 2016 | \$ 5,145                                       | \$ 6,236                | \$ 2,149                      | \$ 1,922 | \$ 72           | \$ 179     | \$ 15,703 |



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Transactions in the allowance for loan losses for the three months ended September 30, 2015 were as follows:

|   | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total     |
|---|--|-------------------------|-------------------------------|----------|-----------------|------------|-----------|
| Allowance for loan losses, July 1, 2015       | \$ 6,598                                       | \$ 5,928                | \$ 2,612                      | \$ 2,118 | \$ 98           | \$ 150     | \$ 17,504 |
| Charge-offs                                   | (80)   | 0                       | (191)                         | (448)    | (17)            | (54)       | (790)     |
| Recoveries                                    | 12   | 1                       | 4                             | 21       | 3               | 18         | 59        |
| Provision (benefit) for loan losses           | 89   | (384)                   | 115                           | 585      | 14              | 44         | 463       |
| Allowance for loan losses, September 30, 2015 | \$ 6,619                                       | \$ 5,545                | \$ 2,540                      | \$ 2,276 | \$ 98           | \$ 158     | \$ 17,236 |

Transactions in the allowance for loan losses for the nine months ended September 30, 2015 were as follows:

|   | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total     |
|---|--|-------------------------|-------------------------------|----------|-----------------|------------|-----------|
| Allowance for loan losses, January 1, 2015    | \$ 7,114                                       | \$ 5,310                | \$ 2,479                      | \$ 2,205 | \$ 71           | \$ 194     | \$ 17,373 |
| Charge-offs                                   | (219)  | 0                       | (347)                         | (1,448)  | (103)           | (159)      | (2,276)   |
| Recoveries                                    | 39   | 51                      | 5                             | 76       | 8               | 68         | 247       |
| Provision (benefit) for loan losses           | (315)  | 184                     | 403                           | 1,443    | 122             | 55         | 1,892     |
| Allowance for loan losses, September 30, 2015 | \$ 6,619                                       | \$ 5,545                | \$ 2,540                      | \$ 2,276 | \$ 98           | \$ 158     | \$ 17,236 |

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and is based on the Corporation's impairment method as of September 30, 2016 and December 31, 2015. The recorded investment in loans excludes accrued interest and unearned discounts due to their insignificance.

**September 30, 2016**

|   | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total     |
|---|--|-------------------------|-------------------------------|----------|-----------------|------------|-----------|
| Allowance for loan losses:                      |  |                         |                               |          |                 |            |           |
| Ending allowance balance attributable to loans: |  |                         |                               |          |                 |            |           |
| Individually evaluated for impairment           | \$ 193   | \$ 0                    | \$ 0                          | \$ 0     | \$ 0            | \$ 0       | \$ 193    |
| Collectively evaluated for impairment           | 4,824  | 3,811                   | 2,149                         | 1,922    | 72              | 179        | 12,957    |
| Acquired with deteriorated credit quality       | 0  | 0                       | 0                             | 0        | 0               | 0          | 0         |
| Modified in a troubled debt restructuring       | 128  | 2,425                   | 0                             | 0        | 0               | 0          | 2,553     |
| Total ending allowance balance                  | \$ 5,145                                       | \$ 6,236                | \$ 2,149                      | \$ 1,922 | \$ 72           | \$ 179     | \$ 15,703 |

## Loans:

|   |         |         |         |        |       |      |           |
|---|---------|---------|---------|--------|-------|------|-----------|
| Individually evaluated for impairment     | \$ 820  | \$ 0    | \$ 0    | \$ 0   | \$ 0  | \$ 0 | \$ 820    |
| Collectively evaluated for impairment     | 565,737 | 497,318 | 644,545 | 77,405 | 5,842 | 73   | 1,790,920 |
| Acquired with deteriorated credit quality | 0       | 660     | 0       | 0      | 0     | 0    | 660       |
| Modified in a troubled debt restructuring | 2,710   | 9,362   | 0       | 0      | 0     | 0    | 12,072    |

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|                            |            |            |            |           |          |       |              |
|----------------------------|------------|------------|------------|-----------|----------|-------|--------------|
| Total ending loans balance | \$ 569,267 | \$ 507,340 | \$ 644,545 | \$ 77,405 | \$ 5,842 | \$ 73 | \$ 1,804,472 |
|----------------------------|------------|------------|------------|-----------|----------|-------|--------------|

December 31, 2015

|   | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total     |
|---|--|-------------------------|-------------------------------|----------|-----------------|------------|-----------|
| Allowance for loan losses:                      |  |                         |                               |          |                 |            |           |
| Ending allowance balance attributable to loans: |  |                         |                               |          |                 |            |           |
| Individually evaluated for impairment           | \$ 239   | \$ 0                    | \$ 39                         | \$ 0     | \$ 0            | \$ 0       | \$ 278    |
| Collectively evaluated for impairment           | 4,909  | 3,580                   | 2,436                         | 2,371    | 90              | 161        | 13,547    |
| Acquired with deteriorated credit quality       | 0  | 0                       | 0                             | 0        | 0               | 0          | 0         |
| Modified in a troubled debt restructuring       | 887  | 2,025                   | 0                             | 0        | 0               | 0          | 2,912     |
| Total ending allowance balance                  | \$ 6,035                                       | \$ 5,605                | \$ 2,475                      | \$ 2,371 | \$ 90           | \$ 161     | \$ 16,737 |

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## Loans:

|   |            |            |            |           |          |          |              |
|---|------------|------------|------------|-----------|----------|----------|--------------|
| Individually evaluated for impairment     | \$ 1,196   | \$ 393     | \$ 248     | \$ 0      | \$ 0     | \$ 0     | \$ 1,837     |
| Collectively evaluated for impairment     | 469,128    | 437,200    | 573,977    | 78,345    | 5,201    | 1,040    | 1,564,891    |
| Acquired with deteriorated credit quality | 0          | 685        | 0          | 0         | 0        | 0        | 685          |
| Modified in a troubled debt restructuring | 5,040      | 9,901      | 0          | 0         | 0        | 0        | 14,941       |
| Total ending loans balance                | \$ 475,364 | \$ 448,179 | \$ 574,225 | \$ 78,345 | \$ 5,201 | \$ 1,040 | \$ 1,582,354 |

The following tables present information related to loans individually evaluated for impairment, including loans modified in troubled debt restructurings, by portfolio segment as of September 30, 2016 and December 31, 2015 and for the three and nine months ended September 30, 2016 and 2015:

**September 30, 2016**

|  | Unpaid Principal<br>Balance | Recorded<br>Investment | Allowance for Loan<br>Losses<br>Allocated |
|--|-----------------------------|------------------------|---|
| <b>With an allowance recorded:</b>         |                             |                        |   |
| Commercial, industrial, and agricultural   | \$ 1,689                    | \$ 1,689               | \$ 321                                    |
| Commercial mortgage                        | 10,148                      | 9,362                  | 2,425                                     |
| Residential real estate                    | 0                           | 0                      | 0   |
| <b>With no related allowance recorded:</b> |                             |                        |   |
| Commercial, industrial, and agricultural   | 2,763                       | 1,841                  | 0   |
| Commercial mortgage                        | 0                           | 0                      | 0   |
| Residential real estate                    | 0                           | 0                      | 0   |
| <b>Total</b>                               | <b>\$ 14,600</b>            | <b>\$ 12,892</b>       | <b>\$ 2,746</b>                           |

**December 31, 2015**

|  | Unpaid Principal<br>Balance | Recorded<br>Investment | Allowance for Loan<br>Losses<br>Allocated |
|--|-----------------------------|------------------------|---|
| <b>With an allowance recorded:</b>         |                             |                        |   |
| Commercial, industrial, and agricultural   | \$ 3,448                    | \$ 3,448               | \$ 1,126                                  |
| Commercial mortgage                        | 5,985                       | 5,343                  | 2,025                                     |
| Residential real estate                    | 351                         | 248                    | 39  |
| <b>With no related allowance recorded:</b> |                             |                        |   |
| Commercial, industrial, and agricultural   | 3,716                       | 2,788                  | 0   |
| Commercial mortgage                        | 5,001                       | 4,951                  | 0   |
| Residential real estate                    | 0                           | 0                      | 0   |
| <b>Total</b>                               | <b>\$ 18,501</b>            | <b>\$ 16,778</b>       | <b>\$ 3,190</b>                           |

|                                    | Three Months Ended September 30, 2016 |                                  |   | Nine Months Ended September 30, 2016 |                                  |   |
|------------------------------------|---------------------------------------|----------------------------------|---|--------------------------------------|----------------------------------|---|
|                                    | Average<br>Recorded<br>Investment     | Interest<br>Income<br>Recognized | Cash<br>Basis<br>Interest<br>Recognized | Average<br>Recorded<br>Investment    | Interest<br>Income<br>Recognized | Cash<br>Basis<br>Interest<br>Recognized |
| <b>With an allowance recorded:</b> |                                       |                                  |   |                                      |                                  |   |

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|  |                  |               |               |                  |               |               |
|--|------------------|---------------|---------------|------------------|---------------|---------------|
| Commercial, industrial, and agricultural | \$ 2,340         | \$ 34         | \$ 34         | \$ 2,859         | \$ 36         | \$ 36         |
| Commercial mortgage                      | 7,253            | 57            | 57            | 6,331            | 61            | 61            |
| Residential real estate                  | 0                | 0             | 0             | 83               | 6             | 6             |
| With no related allowance recorded:      |                  |               |               |                  |               |               |
| Commercial, industrial, and agricultural | 2,148            | 24            | 24            | 2,420            | 26            | 26            |
| Commercial mortgage                      | 2,214            | 17            | 17            | 3,467            | 20            | 20            |
| Residential real estate                  | 0                | 0             | 0             | 0                | 0             | 0             |
| <b>Total</b>                             | <b>\$ 13,955</b> | <b>\$ 132</b> | <b>\$ 132</b> | <b>\$ 15,160</b> | <b>\$ 149</b> | <b>\$ 149</b> |

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|  | Three Months Ended September 30, 2015 |                            |                                | Nine Months Ended September 30, 2015 |                            |                                |
|--|---------------------------------------|----------------------------|--------------------------------|--------------------------------------|----------------------------|--------------------------------|
|  | Average Recorded Investment           | Interest Income Recognized | Cash Basis Interest Recognized | Average Recorded Investment          | Interest Income Recognized | Cash Basis Interest Recognized |
| <b>With an allowance recorded:</b>         |                                       |                            |                                |                                      |                            |                                |
| Commercial, industrial, and agricultural   | \$ 6,463                              | \$ 0                       | \$ 0                           | \$ 6,129                             | \$ 42                      | \$ 42                          |
| Commercial mortgage                        | 7,474                                 | 0                          | 0                              | 8,069                                | 0                          | 0                              |
| Residential real estate                    | 400                                   | 5                          | 5                              | 400                                  | 18                         | 18                             |
| <b>With no related allowance recorded:</b> |                                       |                            |                                |                                      |                            |                                |
| Commercial, industrial, and agricultural   | 1,549                                 | 0                          | 0                              | 1,496                                | 10                         | 10                             |
| Commercial mortgage                        | 4,656                                 | 0                          | 0                              | 4,822                                | 0                          | 0                              |
| Residential real estate                    | 0                                     | 0                          | 0                              | 129                                  | 6                          | 6                              |
| <b>Total</b>                               | <b>\$ 20,542</b>                      | <b>\$ 5</b>                | <b>\$ 5</b>                    | <b>\$ 21,045</b>                     | <b>\$ 76</b>               | <b>\$ 76</b>                   |

The following table presents the recorded investment in nonaccrual loans and loans past due over 90 days still accruing interest by class of loans as of September 30, 2016 and December 31, 2015:

|  | September 30, 2016 |                       | December 31, 2015 |                       |
|--|--------------------|-----------------------|-------------------|-----------------------|
|  | Nonaccrual         | Past Due Over 90 Days | Nonaccrual        | Past Due Over 90 Days |
|  |                    | Still on Accrual      |                   | Still on Accrual      |
| Commercial, industrial, and agricultural | \$ 2,830           | \$ 0                  | \$ 3,560          | \$ 3                  |
| Commercial mortgages                     | 5,592              | 0                     | 3,651             | 0                     |
| Residential real estate                  | 5,733              | 27                    | 3,671             | 87                    |
| Consumer                                 | 1,170              | 15                    | 1,277             | 15                    |
| Credit cards                             | 0                  | 28                    | 0                 | 0                     |
| <b>Total</b>                             | <b>\$ 15,325</b>   | <b>\$ 70</b>          | <b>\$ 12,159</b>  | <b>\$ 105</b>         |

Nonaccrual loans and loans past due over 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

The following table presents the aging of the recorded investment in past due loans as of September 30, 2016 and December 31, 2015 by class of loans.

**September 30, 2016**

|  | 30-59 Days Past Due | 60-89 Days Past Due | Greater Than     | Total Past Due | Loans Not Past Due | Total      |
|--|---------------------|---------------------|------------------|----------------|--------------------|------------|
|  |                     |                     | 90 Days Past Due |                |                    |            |
| Commercial, industrial, and agricultural | \$ 1,641            | \$ 269              | \$ 1,910         | \$ 3,820       | \$ 565,447         | \$ 569,267 |
| Commercial mortgages                     | 2                   | 727                 | 2,043            | 2,772          | 504,568            | 507,340    |
| Residential real estate                  | 1,680               | 354                 | 2,451            | 4,485          | 640,060            | 644,545    |
| Consumer                                 | 286                 | 150                 | 1,185            | 1,621          | 75,784             | 77,405     |
| Credit cards                             | 24                  | 39                  | 28               | 91             | 5,751              | 5,842      |

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|            |          |          |          |           |              |              |
|------------|----------|----------|----------|-----------|--------------|--------------|
| Overdrafts | 0        | 0        | 0        | 0         | 73           | 73           |
| Total      | \$ 3,633 | \$ 1,539 | \$ 7,617 | \$ 12,789 | \$ 1,791,683 | \$ 1,804,472 |

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December 31, 2015

|  | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | Greater Than<br>90 Days<br>Past Due | Total<br>Past Due | Loans Not<br>Past Due | Total               |
|--|------------------------|------------------------|-------------------------------------|-------------------|-----------------------|---------------------|
| Commercial, industrial, and agricultural | \$ 131                 | \$ 622                 | \$ 698                              | \$ 1,451          | \$ 473,913            | \$ 475,364          |
| Commercial mortgages                     | 7                      | 343                    | 3,651                               | 4,001             | 444,178               | 448,179             |
| Residential real estate                  | 2,834                  | 378                    | 3,001                               | 6,213             | 568,012               | 574,225             |
| Consumer                                 | 216                    | 179                    | 1,292                               | 1,687             | 76,658                | 78,345              |
| Credit cards                             | 0                      | 0                      | 0                                   | 0                 | 5,201                 | 5,201               |
| Overdrafts                               | 0                      | 0                      | 0                                   | 0                 | 1,040                 | 1,040               |
| <b>Total</b>                             | <b>\$ 3,188</b>        | <b>\$ 1,522</b>        | <b>\$ 8,642</b>                     | <b>\$ 13,352</b>  | <b>\$ 1,569,002</b>   | <b>\$ 1,582,354</b> |

**Troubled Debt Restructurings**

The terms of certain loans have been modified as troubled debt restructurings. The modification of the terms of such loans included either or both of the following: a reduction of the stated interest rate of the loan or an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk.

The following table presents the number of loans, loan balances, and specific reserves for loans that have been restructured in a troubled debt restructuring as of September 30, 2016 and December 31, 2015.

|  | September 30, 2016 |                  |                     | December 31, 2015  |                  |                     |
|--|--------------------|------------------|---------------------|--------------------|------------------|---------------------|
|  | Number of<br>Loans | Loan<br>Balance  | Specific<br>Reserve | Number of<br>Loans | Loan<br>Balance  | Specific<br>Reserve |
| Commercial, industrial, and agricultural | 7                  | \$ 2,710         | \$ 128              | 8                  | \$ 5,040         | \$ 887              |
| Commercial mortgages                     | 8                  | 9,362            | 2,425               | 8                  | 9,901            | 2,025               |
| Residential real estate                  | 0                  | 0                | 0                   | 0                  | 0                | 0                   |
| Consumer                                 | 0                  | 0                | 0                   | 0                  | 0                | 0                   |
| Credit cards                             | 0                  | 0                | 0                   | 0                  | 0                | 0                   |
| <b>Total</b>                             | <b>15</b>          | <b>\$ 12,072</b> | <b>\$ 2,553</b>     | <b>16</b>          | <b>\$ 14,941</b> | <b>\$ 2,912</b>     |

The following table present loans by class modified as troubled debt restructurings that occurred during the nine months ended September 30, 2016. There was one loan modified as a troubled debt restructuring during the three and nine months ended September 30, 2016.

|  | Number of<br>Loans | Nine Months Ended September 30, 2016                   |   |
|--|--------------------|--|---|
|  |                    | Pre-Modification<br>Outstanding Recorded<br>Investment | Post-Modification<br>Outstanding Recorded<br>Investment |
| Commercial, industrial, and agricultural | 1                  | \$ 109   | \$ 109  |
| Commercial mortgages                     | 0                  | 0  | 0   |
| Residential real estate                  | 0                  | 0  | 0   |
| Consumer                                 | 0                  | 0  | 0   |
| Credit cards                             | 0                  | 0  | 0   |
| <b>Total</b>                             | <b>1</b>           | <b>\$ 109</b>  | <b>\$ 109</b>   |

There were no loans modified as troubled debt restructurings during the three or nine months ended September 30, 2015.

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A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms. All loans modified in troubled debt restructurings are performing in accordance with their modified terms as of September 30, 2016 and December 31, 2015 and no principal balances were forgiven in connection with the loan restructurings.

In order to determine whether a borrower is experiencing financial difficulty, the Corporation performs an evaluation using its internal underwriting policies of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without a loan modification. The Corporation has no further loan commitments to customers whose loans are classified as a troubled debt restructuring.

**Credit Quality Indicators**

The Corporation classifies commercial, industrial, and agricultural loans and commercial mortgage loans into risk categories based on relevant information about the ability of borrowers to service their debt, such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. Loans with outstanding balances greater than \$1 million are analyzed at least semiannually and loans with outstanding balances of less than \$1 million are analyzed at least annually.

The Corporation uses the following definitions for risk ratings:

**Special Mention:** Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Corporation's credit position at some future date.

**Substandard:** Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected.

**Doubtful:** Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not rated as special mention, substandard, or doubtful are considered to be pass rated loans. All loans included in the following tables have been assigned a risk rating within 12 months of the balance sheet date.

**September 30, 2016**

|  | Pass                | Special<br>Mention | Substandard      | Doubtful    | Total               |
|--|---------------------|--------------------|------------------|-------------|---------------------|
| Commercial, industrial, and agricultural | \$ 530,168          | \$ 21,155          | \$ 17,936        | \$ 8        | \$ 569,267          |
| Commercial mortgages                     | 484,374             | 2,641              | 20,325           | 0           | 507,340             |
| <b>Total</b>                             | <b>\$ 1,014,542</b> | <b>\$ 23,796</b>   | <b>\$ 38,261</b> | <b>\$ 8</b> | <b>\$ 1,076,607</b> |

**December 31, 2015**

|  | Pass              | Special<br>Mention | Substandard      | Doubtful      | Total             |
|--|-------------------|--------------------|------------------|---------------|-------------------|
| Commercial, industrial, and agricultural | \$ 447,449        | \$ 4,749           | \$ 22,943        | \$ 223        | \$ 475,364        |
| Commercial mortgages                     | 426,870           | 1,735              | 19,148           | 426           | 448,179           |
| <b>Total</b>                             | <b>\$ 874,319</b> | <b>\$ 6,484</b>    | <b>\$ 42,091</b> | <b>\$ 649</b> | <b>\$ 923,543</b> |



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The Corporation considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential real estate, consumer, and credit card loan classes, the Corporation also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in residential, consumer, and credit card loans based on payment activity as of September 30, 2016 and December 31, 2015:

|                | September 30, 2016         |                  |                 | December 31, 2015          |                  |                 |
|----------------|----------------------------|------------------|-----------------|----------------------------|------------------|-----------------|
|                | Residential<br>Real Estate | Consumer         | Credit<br>Cards | Residential<br>Real Estate | Consumer         | Credit<br>Cards |
| Performing     | \$ 638,785                 | \$ 76,220        | \$ 5,814        | \$ 570,467                 | \$ 77,053        | \$ 5,201        |
| Non-performing | 5,760                      | 1,185            | 28              | 3,758                      | 1,292            | 0               |
| <b>Total</b>   | <b>\$ 644,545</b>          | <b>\$ 77,405</b> | <b>\$ 5,842</b> | <b>\$ 574,225</b>          | <b>\$ 78,345</b> | <b>\$ 5,201</b> |

The Corporation's portfolio of residential real estate and consumer loans maintained within Holiday Financial Services Corporation ( Holiday ) are considered to be subprime loans. Holiday is a subsidiary that offers small balance unsecured and secured loans primarily collateralized by automobiles and equipment, to borrowers with higher risk characteristics than are typical in the Bank's consumer loan portfolio.

Holiday's loan portfolio is summarized as follows at September 30, 2016 and December 31, 2015:

|                         | September 30,<br>2016 | December 31,<br>2015 |
|-------------------------|-----------------------|----------------------|
| Consumer                | \$ 25,268             | \$ 30,001            |
| Residential real estate | 1,166                 | 1,263                |
| Less: unearned discount | (3,614)               | (4,556)              |
| <b>Total</b>            | <b>\$ 22,820</b>      | <b>\$ 26,708</b>     |

**7. DEPOSITS**

Total deposits at September 30, 2016 and December 31, 2015 are summarized as follows (in thousands):

|                                | Percentage<br>Change | September 30,<br>2016 | December 31,<br>2015 |
|--------------------------------|----------------------|-----------------------|----------------------|
| Checking, non-interest bearing | 11.2%                | \$ 293,049            | \$ 263,639           |
| Checking, interest bearing     | 20.1%                | 528,728               | 440,174              |
| Savings accounts               | 3.7%                 | 961,260               | 927,074              |
| Certificates of deposit        | 30.7%                | 240,744               | 184,166              |
|                                | 11.5%                | \$ 2,023,781          | \$ 1,815,053         |

**8. EARNINGS PER SHARE**

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the applicable period, excluding outstanding participating securities. Diluted earnings per share is computed using the weighted average number of shares determined for the basic computation plus the dilutive effect of potential common shares issuable under certain stock compensation plans. For the three and nine months ended September 30, 2016 and 2015, there were no outstanding stock options to include in the diluted earnings per share calculations.



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Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are included in the computation of earnings per share pursuant to the two-class method. The Corporation has determined that its outstanding unvested stock awards are participating securities.

The computation of basic and diluted earnings per share is shown below (in thousands except per share data):

|  | Three months ended<br>September 30, |          | Nine months ended<br>September 30, |           |
|--|-------------------------------------|----------|------------------------------------|-----------|
|  | 2016                                | 2015     | 2016                               | 2015      |
| <b>Basic earnings per common share computation:</b>  |                                     |          |                                    |           |
| Net income per consolidated statements of income   | \$ 6,416                            | \$ 5,522 | \$ 15,500                          | \$ 16,689 |
| Net earnings allocated to participating securities   | (40)                                | (30)     | (101)                              | (92)      |
| Net earnings allocated to common stock   | \$ 6,376                            | \$ 5,492 | \$ 15,399                          | \$ 16,597 |
| Distributed earnings allocated to common stock   | \$ 2,370                            | \$ 2,363 | \$ 7,107                           | \$ 7,095  |
| Undistributed earnings allocated to common stock   | 4,006                               | 3,129    | 8,292                              | 9,502     |
| Net earnings allocated to common stock   | \$ 6,376                            | \$ 5,492 | \$ 15,399                          | \$ 16,597 |
| Weighted average common shares outstanding, including shares considered participating securities | 14,464                              | 14,406   | 14,453                             | 14,408    |
| Less: Average participating securities   | (82)                                | (71)     | (85)                               | (72)      |
| Weighted average shares  | 14,382                              | 14,335   | 14,368                             | 14,336    |
| Basic earnings per common share  | \$ 0.44                             | \$ 0.38  | \$ 1.07                            | \$ 1.16   |
| <b>Diluted earnings per common share computation:</b>  |                                     |          |                                    |           |
| Net earnings allocated to common stock   | \$ 6,376                            | \$ 5,492 | \$ 15,399                          | \$ 16,597 |
| Weighted average shares and dilutive potential common shares                                     | 14,382                              | 14,335   | 14,368                             | 14,336    |
| Diluted earnings per common share  | \$ 0.44                             | \$ 0.38  | \$ 1.07                            | \$ 1.16   |

**9. DERIVATIVE INSTRUMENTS**

On May 3, 2011, the Corporation executed an interest rate swap agreement with a 5 year term and an effective date of September 15, 2013 in order to hedge cash flows associated with \$10 million of a subordinated note that was issued by the Corporation during 2007 and elected cash flow hedge accounting for the agreement. The Corporation's objective in using this derivative is to add stability to interest expense and to manage its exposure to interest rate risk. The interest rate swap involves the receipt of variable-rate amounts in exchange for fixed-rate payments from September 15, 2013 to September 15, 2018 without exchange of the underlying notional amount. At September 30, 2016, the variable rate on the subordinated debt was 2.40% (LIBOR plus 155 basis points) and the Corporation was paying 5.57% (4.02% fixed rate plus 155 basis points).

As of September 30, 2016 and December 31, 2015, no derivatives were designated as fair value hedges or hedges of net investments in foreign operations. Additionally, the Corporation does not use derivatives for trading or speculative purposes and currently does not have any derivatives that are not designated as hedges.

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The following tables provide information about the amounts and locations of activity related to the interest rate swaps designated as cash flow hedges within the Corporation's consolidated balance sheet and statement of income as of September 30, 2016 and December 31, 2015 and for the three and nine months ended September 30, 2016 and 2015:

|                         | Balance Sheet<br>Location                     | Fair value as of<br>September 30,<br>2016 | December 31,<br>2015 |
|-------------------------|---|---|----------------------|
| Interest rate contracts | Accrued interest and<br><br>other liabilities | <br><br>(\$595)                           | <br><br>(\$736)      |

**For the Three Months**

| Ended September 30, 2016 | (a)  | (b)   | (c)    | (d)             | (e) |
|--------------------------|------|---|--------|-----------------|-----|
| Interest rate contracts  |      | Interest expense<br>subordinated debentures | (\$84) | Other<br>income | \$0 |
|                          | \$87 |   |        |                 |     |

**For the Nine Months**

| Ended September 30, 2016 | (a)  | (b)   | (c)     | (d)             | (e) |
|--------------------------|------|---|---------|-----------------|-----|
| Interest rate contracts  |      | Interest expense<br>subordinated debentures | (\$260) | Other<br>income | \$0 |
|                          | \$92 |   |         |                 |     |

**For the Three Months**

| Ended September 30, 2015 | (a)    | (b)   | (c)    | (d)             | (e) |
|--------------------------|--------|---|--------|-----------------|-----|
| Interest rate contracts  |        | Interest expense<br>subordinated debentures | (\$95) | Other<br>income | \$0 |
|                          | (\$19) |   |        |                 |     |

**For the Nine Months**

| Ended September 30, 2015 | (a)  | (b)   | (c)     | (d)             | (e) |
|--------------------------|------|---|---------|-----------------|-----|
| Interest rate contracts  |      | Interest expense<br>subordinated debentures | (\$284) | Other<br>income | \$0 |
|                          | \$25 |   |         |                 |     |

- (a) Amount of Gain or (Loss) Recognized in Other Comprehensive Loss on Derivative (Effective Portion), net of tax
  - (b) Location of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)
  - (c) Amount of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)
  - (d) Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
  - (e) Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
- Amounts reported in accumulated other comprehensive loss related to the interest rate swap will be reclassified to interest expense as interest payments are made on the subordinated debentures. Such amounts reclassified from accumulated other comprehensive loss to interest expense in the next twelve months are expected to be \$337. As of September 30, 2016 and December 31, 2015, a cash collateral balance in the amount of \$1,400 was maintained with a counterparty to the interest rate swaps. These balances are included in interest bearing deposits with other banks on the consolidated balance sheet.

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The Corporation has entered into certain interest rate swap contracts that are not designated as hedging instruments. These derivative contracts relate to transactions in which the Corporation enters into an interest rate swap with a customer while at the same time entering into an offsetting interest rate swap with another financial institution. In connection with each swap transaction, the Corporation agrees to pay interest to the customer on a notional amount at a variable interest rate and receive interest from the customer on a similar notional amount at a fixed interest rate. Concurrently, the Corporation agrees to pay another financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. The transaction allows the Corporation's customers to effectively convert a variable rate loan to a fixed rate. Because the Corporation acts as an intermediary for its customer, changes in the fair value of the underlying derivative contracts offset each other and do not impact the Corporation's results of operations.

The Corporation pledged cash collateral to another financial institution with a balance of \$200 as of September 30, 2016. This balance is included in interest bearing deposits with other banks on the consolidated balance sheets. The Corporation does not require its customers to post cash or securities as collateral on its program of back-to-back swaps. However, certain language is included in the International Swaps and Derivatives Association agreement and loan documents where, in default situations, the Corporation is permitted to access collateral supporting the loan relationship to recover any losses suffered on the derivative asset or liability. The Corporation may be required to post additional collateral to swap counterparties in the future in proportion to potential increases in unrealized loss positions.

The following table provides summary information about the amounts and locations of activity related to the back-to-back interest rate swaps within the Corporation's consolidated balance sheet as of September 30, 2016 and December 31, 2015:

|   | Notional Amount | Average Maturity (in years) | Weighted Average Fixed Rate | Weighted Average Variable Rate | Fair Value |
|---|-----------------|-----------------------------|-----------------------------|--------------------------------|------------|
| <b>September 30, 2016</b>                 |                 |                             |                             |                                |            |
| 3 <sup>rd</sup> Party interest rate swaps | \$ 10,326       | 10.1                        | 3.90%                       | 1 month LIBOR + 2.03%          | \$ 766(f)  |
| Customer interest rate swaps              | (10,326)        | 10.1                        | 3.90%                       | 1 month LIBOR + 2.03%          | (766)(g)   |
| <b>December 31, 2015</b>                  |                 |                             |                             |                                |            |
| 3 <sup>rd</sup> Party interest rate swaps | \$ 6,751        | 9.4                         | 4.42%                       | 1 month LIBOR + 2.25%          | \$ 131(f)  |
| Customer interest rate swaps              | (6,751)         | 9.4                         | 4.42%                       | 1 month LIBOR + 2.25%          | (131)(g)   |

(f) Reported in accrued interest receivable and other assets within the consolidated balance sheets

(g) Reported in accrued interest payable and other liabilities within the consolidated balance sheets

**10. RECENT ACCOUNTING PRONOUNCEMENTS**

In August 2016, the FASB issued an update (ASU 2016-15, Statement of Cash Flows) which addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments in this Update apply to all entities, including business entities and not-for-profit entities that are required to present a statement of cash flows, and are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The adoption of ASU 2016-15 is not expected to have a material effect on the Corporation's financial statements.

In June 2016, the FASB issued an update (ASU 2016-13, Financial Instruments - Credit Losses) which will require recognition of an entity's current estimate of all expected credit losses for assets measured at amortized cost. The amendments in ASU 2016-13 eliminate the probable initial recognition threshold in current U.S. Generally Accepted Accounting Principles. In addition, the amendments in ASU 2016-13 broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually, such as loans. The update will be effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted for interim and annual reporting periods beginning after December 15, 2018. Management is currently evaluating the impact of the adoption of ASU 2016-13 on the Corporation's financial statements.

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In March 2016, the FASB issued an update (ASU 2016-09, Compensation-Stock Compensation: Improvements to Employee Share-Based Payment Accounting) which will require recognition of the income tax effects of share-based awards in the income statement when the awards vest or are settled (i.e., Additional Paid-in-Capital pools will be eliminated). The guidance in this ASU will become effective for interim and annual reporting periods beginning after December 15, 2016, with early adoption permitted. The adoption of ASU 2016-09 is not expected to have a material effect on the Corporation's financial statements.

In March 2016, the FASB issued an update (ASU 2016-06, Derivatives and Hedging: Contingent Put and Call Options in Debt Instruments) which clarifies that an assessment of whether an embedded contingent put or call option is clearly and closely related to the debt host requires only an analysis of the four-step decision sequence in ASC 815-15-25-42. Entities are required to apply the guidance to existing debt instruments (or hybrid financial instruments that are determined to have a debt host) using a modified retrospective transition method as of the period of adoption. The guidance in this ASU will become effective for interim and annual reporting periods beginning after December 15, 2016, with early adoption permitted. The adoption of ASU 2016-06 is not expected to have a material effect on the Corporation's financial statements.

In February 2016, the FASB issued Accounting Standards Update 2016-02, Leases (Topic 842). ASU 2016-02 requires a lessee to recognize lease assets and lease liabilities that arise from all leases. In addition, lessor accounting guidance will be changed to conform to the new guidance. The update will be effective for reporting periods beginning after December 15, 2018. Early adoption is permitted. Management is currently evaluating the impact of the adoption of ASU 2016-02 on the Corporation's financial statements.

In January 2016, the FASB issued Accounting Standards Update 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 provides updated accounting and reporting requirements for both public and non-public entities. The most significant provisions that will impact the Corporation are: 1) equity securities available for sale will be measured at fair value, with the changes in fair value recognized in the income statement; 2) eliminate the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments at amortized cost on the balance sheet; 3) utilization of exit price notion when measuring the fair value of financial instruments for disclosure purposes; 4) require separate presentation of both financial assets and liabilities by measurement category and form of financial asset on the balance sheet or accompanying notes to the financial statements. The update will be effective for interim and annual reporting periods beginning after December 15, 2017, using a cumulative-effect adjustment to the balance sheet as of the beginning of the year adoption. Early adoption is not permitted. The adoption of ASU 2016-01 is not expected to have a material effect on the Corporation's financial statements.

In June 2014, the FASB issued Accounting Standards Update 2014-12, Compensation - Stock Compensation (Topic 718). ASU 2014-12 clarifies that entities should treat performance targets that can be met after the requisite service period of a share-based payment award as performance conditions that affect vesting. Therefore, an entity would not record compensation expense (measured as of the grant date without taking into account the effect of the performance target) related to an award for which transfer to the employee is contingent on the entity's satisfaction of a performance target until it becomes probable that the performance target will be met. No new disclosures are required under ASU 2014-12. The guidance is effective for reporting periods beginning after December 15, 2015. The adoption of ASU 2014-12 did not have a material effect on the Corporation's financial statements.

In May 2014, FASB issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers (Topic 606). The ASU creates a new topic, Topic 606, to provide guidance on revenue recognition for entities that enter into contracts with customers to transfer goods or services or enter into contracts for the transfer of nonfinancial assets. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Additional disclosures are required to provide quantitative and qualitative information regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new guidance is effective for annual reporting periods, and interim reporting periods within those annual periods, beginning after December 15, 2017. Early adoption is not permitted. Management is currently evaluating the impact of the adoption of this guidance on the Corporation's financial statements.

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**ITEM 2**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
AND RESULTS OF OPERATIONS**

The following discussion and analysis of the consolidated financial statements of the Corporation is presented to provide insight into management's assessment of financial results. The Corporation's subsidiary, CNB Bank (the Bank), provides financial services to individuals and businesses primarily within its primary market area of the Pennsylvania counties of Blair, Cambria, Cameron, Centre, Clearfield, Crawford, Elk, Indiana, Jefferson, and McKean. As ERIEBANK, a division of CNB Bank, the Bank operates in the Pennsylvania counties of Crawford, Erie, and Warren, and the Ohio counties of Ashtabula and Lake. As FCBank, a division of CNB Bank, the Bank operates in the Ohio counties of Crawford, Richland, Ashland, Wayne, Marion, Morrow, Knox, Holmes, Delaware, Franklin, and Fairfield.

The Bank is subject to regulation, supervision and examination by the Pennsylvania State Department of Banking as well as the Federal Deposit Insurance Corporation. The financial condition and results of operations of the Corporation and its consolidated subsidiaries are not necessarily indicative of future performance. CNB Securities Corporation is incorporated in Delaware and currently maintains investments in debt and equity securities. CNB Insurance Agency, incorporated in Pennsylvania, provides for the sale of nonproprietary annuities and other insurance products. Holiday Financial Services Corporation (Holiday), incorporated in Pennsylvania, offers small balance unsecured loans and secured loans, primarily collateralized by automobiles and equipment, to borrowers with higher risk characteristics.

When we use the terms we, us and our, we mean CNB Financial Corporation and its subsidiaries. Management's discussion and analysis should be read in conjunction with the Corporation's consolidated financial statements and related notes.

The following discussion should be read in conjunction with the Corporation's Consolidated Financial Statements and Notes thereto, for the year ended December 31, 2015, included in its 2015 Form 10-K, and in conjunction with the Consolidated Financial Statements and Notes thereto included in Item 1 of this report. Operating results for the three and nine months ended September 30, 2016 are not necessarily indicative of the results for the full year ending December 31, 2016, or any future period.

**COMPLETED ACQUISITION / NORTHEAST OHIO MARKET**

On July 15, 2016, the Corporation completed its previously announced acquisition of Lake National Bank (LNB) of Mentor, Ohio for \$22.50 per share in cash, resulting in consideration paid to LNB shareholders of \$24.75 million. Following completion of the merger, the two branches of LNB in Mentor, Ohio are operating as part of the ERIEBANK division of CNB Bank.

In order to facilitate its entry into northeastern Ohio as ERIEBANK, the Corporation had opened a loan production office in Ashtabula, Ohio in the fourth quarter of 2014. Construction of a full-service branch in Ashtabula began in the third quarter of 2016, with completion anticipated by the end of the first quarter of 2017.

**GENERAL OVERVIEW**

Management uses return on average equity, earnings per share, asset quality, and other metrics to measure the performance of the Corporation. The interest rate environment will continue to play an important role in the future earnings of the Corporation. During the past several years, in order to address the historically low interest rates that are primarily tied to short-term rates, such as the Prime Rate, the Corporation has taken a variety of measures including instituting rate floors on our commercial lines of credit and home equity lines.

Non-interest costs are expected to increase with the growth of the Corporation; however, management's growth strategies are expected to also result in an increase in earning assets as well as enhanced non-interest income which is expected to more than offset increases in non-interest expenses in 2016 and beyond. While past results are not an indication of future earnings, management believes the Corporation is well-positioned to sustain core earnings during 2016.

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### **CASH AND CASH EQUIVALENTS**

Cash and cash equivalents totaled \$36.9 million at September 30, 2016 compared to \$27.3 million at December 31, 2015. Cash and cash equivalents fluctuate based on the timing and amount of liquidity events that occur in the normal course of business.

Management believes the liquidity needs of the Corporation are satisfied by the current balance of cash and cash equivalents, readily available access to traditional funding sources, Federal Home Loan Bank financing, and the portions of the securities and loan portfolios that mature within one year. The Corporation expects that these sources of funds will enable it to meet cash obligations and off-balance sheet commitments as they come due.

### **SECURITIES**

Securities available for sale and trading securities decreased by \$39.2 million or 7.1% since December 31, 2015, and associated cash proceeds were used primarily to fund loan growth. The footnotes to the consolidated financial statements provide more detail concerning the composition of the Corporation's securities portfolio, the process for evaluating securities for other-than-temporary impairment, and for valuation of structured pooled trust preferred securities.

The Corporation generally buys into the market over time and does not attempt to time its transactions. In doing this, the highs and lows of the market are averaged into the portfolio and the overall effect of different rate environments is minimized. The Corporation monitors the earnings performance and the effectiveness of the liquidity of the securities portfolio on a regular basis through meetings of the Asset/Liability Committee of the Corporation's Board of Directors (ALCO). The ALCO also reviews and manages interest rate risk for the Corporation. Through active balance sheet management and analysis of the securities portfolio, a sufficient level of liquidity is maintained to satisfy depositor requirements and various credit needs of our customers.

### **LOANS**

The Corporation experienced an increase in loans, net of unearned discount, of \$223.1 million, or 14.1%, during the first nine months of 2016. Of the total growth, \$122.0 million was acquired from Lake National Bank, and \$101.1 million was organic growth. Lending efforts consist principally of commercial and retail lending, which includes single family residential mortgages and other consumer loans. The Corporation views commercial lending as its competitive advantage and continues to focus on this area by hiring and retaining experienced loan officers and supporting them with quality credit analysis. The Corporation expects loan demand to be solid and loan balances to grow throughout the remainder of 2016.

### **ALLOWANCE FOR LOAN LOSSES**

The allowance for loan losses is established by provisions for losses in the loan portfolio as well as overdrafts in deposit accounts. These provisions are charged against current income. Loans and overdrafts deemed not collectible are charged off against the allowance while any subsequent collections are recorded as recoveries and increase the allowance.

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The table below shows activity within the allowance account for the specified periods (in thousands):

|  | Nine months ending<br>September 30,<br>2016 | Year ending<br>December 31, 2015 | Nine months ending<br>September<br>30, 2015 |
|--|---|----------------------------------|---|
| Balance at beginning of period                   | \$ 16,737                                   | \$ 17,373                        | \$ 17,373                                   |
| Charge-offs:                                     |   |                                  |   |
| Commercial, industrial, and agricultural         | (519)                                       | (307)                            | (219)                                       |
| Commercial mortgages                             | (20)  | (486)                            |   |
| Residential real estate                          | (244)                                       | (632)                            | (347)                                       |
| Consumer   | (2,397)                                     | (1,956)                          | (1,448)                                     |
| Credit cards                                     | (54)  | (116)                            | (103)                                       |
| Overdrafts                                       | (167)                                       | (221)                            | (159)                                       |
|  | (3,401)                                     | (3,718)                          | (2,276)                                     |
| Recoveries:                                      |   |                                  |   |
| Commercial, industrial, and agricultural         | 84  | 267                              | 39  |
| Commercial mortgages                             | 7   | 52                               | 51  |
| Residential real estate                          | 72  | 8                                | 5   |
| Consumer   | 94  | 96                               | 76  |
| Credit cards                                     | 18  | 14                               | 8   |
| Overdraft deposit accounts                       | 54  | 85                               | 68  |
|  | 329   | 522                              | 247   |
| Net charge-offs                                  | (3,072)                                     | (3,196)                          | (2,029)                                     |
| Provision for loan losses                        | 2,038                                       | 2,560                            | 1,892                                       |
| Balance at end of period                         | \$ 15,703                                   | \$ 16,737                        | \$ 17,236                                   |
| Loans, net of unearned                           | \$ 1,800,858                                | \$ 1,577,798                     | \$ 1,516,521                                |
| Allowance to net loans                           | 0.87%                                       | 1.06%                            | 1.14%                                       |
| Net charge-offs to average loans<br>(annualized) | 0.24%                                       | 0.22%                            | 0.19%                                       |
| Nonperforming assets                             | \$ 16,542                                   | \$ 12,918                        | \$ 12,917                                   |
| Nonperforming % of total assets                  | 0.65%                                       | 0.57%                            | 0.57%                                       |

The adequacy of the allowance for loan losses is subject to a formal analysis by the Credit Administration and Finance Departments of the Corporation. As part of the formal analysis, delinquencies and losses are monitored monthly. The loan portfolio is divided into several categories in order to better analyze the entire pool. First is a selection of classified loans that is given a specific reserve. The remaining loans are pooled, by category, into these segments:

**Reviewed**

Commercial, industrial, and agricultural

Commercial mortgages

**Homogeneous**

Residential real estate

Consumer

Credit cards

Overdrafts

The reviewed loan pools are further segregated into four categories: special mention, substandard, doubtful, and pass rated. Historical loss factors are calculated for each pool excluding overdrafts based on the previous eight quarters of experience. The homogeneous pools are evaluated by analyzing the historical loss factors from the most previous quarter end and the two most recent year ends.

The historical loss factors for both the reviewed and homogeneous pools are adjusted based on the following six qualitative factors:

levels of and trends in delinquencies, non-accrual loans, and classified loans;

trends in volume and terms of loans;

effects of any changes in lending policies and procedures;

experience and ability of management;

national and local economic trends and conditions; and

concentrations of credit.

The methodology described above was created using the experience of the Corporation's Management team, guidance from the regulatory agencies, expertise of a third-party loan review provider, and discussions with peers. The resulting factors are applied to the pool balances in order to estimate the probable risk of loss within each pool. Prudent business practices dictate that the level of the allowance, as well as corresponding charges to the provision for loan losses, should be commensurate with identified areas of risk within the loan portfolio and the attendant risks inherent therein. The quality of the credit risk management function and the overall administration of this vital segment of the Corporation's assets are critical to the ongoing success of the Corporation.

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The previously mentioned analysis considers numerous historical and other factors to analyze the adequacy of the allowance and current period charges against the provision for loan losses. Management uses the analysis to compare and plot the actual level of the allowance against the aggregate amount of loans adversely classified in order to compute the estimated probable losses associated with those loans. Management then determines the current adequacy of the allowance and evaluates trends that may be developing. The volume and composition of the Corporation's loan portfolio continue to reflect growth in commercial credits including commercial real estate loans.

As mentioned in the Loans section of this analysis, management considers commercial lending to be a competitive advantage and continues to focus on this area as part of its strategic growth initiatives. However, management recognizes and considers the fact that risk is more pronounced in these types of credits and is, to a greater degree than with other loans, driven by the economic environment in which the debtor's business operates.

During the three and nine months ended September 30, 2016, the Corporation recorded a provision for loan losses of \$622 thousand and \$2.0 million, as compared to a provision for loan losses of \$463 thousand and \$1.9 million for the three and nine months ended September 30, 2015. Net chargeoffs during the three and nine months ended September 30, 2016 were \$907 thousand and \$3.1 million, as compared to \$731 thousand and \$2.0 million for the three and nine months ended September 30, 2015. The increase in chargeoffs was primarily attributable to consumer loans held in CNB's consumer discount company, Holiday Financial Services Corporation. Included in the \$907 thousand and \$3.1 million of net chargeoffs for the three and nine months ended September 30, 2016 were \$581 thousand and \$2.1 million of net chargeoffs related to Holiday Financial Services Corporation. As a result of the purchase accounting requirements associated with a business combination, the allowance for loan losses previously recorded by Lake National Bank did not carry over to the financial statements of CNB. Instead, CNB recorded a fair value adjustment to the loans acquired from Lake National Bank resulting in a reduction in the loan balance of \$4.1 million, which will be accreted into loan income in proportion to the reduction of the loan principal balances.

There were no new impaired commercial loan relationships that required a significant loss reserve in the first nine months of 2016. In addition, one impaired commercial and industrial loan that had a loss reserve of \$671 thousand at June 30, 2016 was repaid in full in July 2016, resulting in no loss to CNB.

Management believes that the allowance for loan losses is reasonable and adequate to absorb probable incurred losses in the Corporation's portfolio at September 30, 2016.

**FUNDING SOURCES**

The Corporation considers deposits, short-term borrowings, and term debt when evaluating funding sources. Deposits increased \$208.7 million from \$1.815 billion at December 31, 2015 to \$2.024 billion at September 30, 2016. \$139.8 million was acquired from Lake National Bank, while \$68.9 million was organic growth. Periodically, the Corporation utilizes term borrowings from the Federal Home Loan Bank (FHLB) and other lenders to meet funding needs. Management plans to maintain access to short-term and long-term borrowings as an available funding source.

During the second quarter of 2016, the Corporation repaid FHLB long-term borrowings totaling \$40.0 million which carried interest rates ranging from 3.97% to 4.60% and incurred an early repayment penalty of \$1.5 million. Resulting interest expense savings for 2016 and 2017 will total \$1.9 million.

In September 2016, CNB completed a private placement of \$50 million in aggregate principal amount of fixed-to-floating rate subordinated notes. The notes will mature in October 2026, and will initially bear interest at a fixed rate of 5.75% per annum, payable semi-annually in arrears, to, but excluding, October 15, 2021, and thereafter to, but excluding, the maturity date or earlier redemption, the interest rate shall reset quarterly to an interest rate per annum equal to the then current three-month LIBOR rate plus 455 basis points. These subordinated notes were designed to qualify as Tier 2 capital under the Federal Reserve's capital guidelines and were given an investment grade rating of BBB- by Kroll Bond Rating Agency. CNB injected the net proceeds from the subordinated notes into its bank subsidiary, CNB Bank, and intends to use the capital for general corporate purposes, including loan growth, additional liquidity, and working capital. As of September 30, 2016, \$35 million of the proceeds from the private placement were held by the Corporation's escrow agent, resulting in an increase in accrued interest receivable and other assets at the end of the third quarter. These proceeds were remitted to the Corporation on the first business day of October 2016.

**Table of Contents****SHAREHOLDERS EQUITY AND CAPITAL RATIOS AND METRICS**

The Corporation's capital continued to provide a base for profitable growth through September 30, 2016. Total shareholders' equity was \$215.5 million at September 30, 2016 and \$201.9 million at December 31, 2015. In the first nine months of 2016, the Corporation earned \$15.5 million and declared dividends of \$7.2 million, resulting in a dividend payout ratio of 46.2% of net income.

The Corporation is required to comply with standards of capital adequacy mandated by banking regulators. On January 1, 2015, rules to implement Basel III capital requirements became effective for community banks.

The rules substantially revised the risk-based capital requirements in comparison to the previously existing U.S. risk-based capital rules. The Basel III Capital Rules, among other things, (i) introduced a new capital measure called Common Equity Tier 1 (CET1), (ii) increased the minimum requirements for Tier 1 Capital ratio as well as the minimum levels to be considered well capitalized under prompt corrective action; (iii) and introduced the capital conservation buffer, designed to absorb losses during periods of economic stress. Institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer are subject to constraints on dividends, equity repurchases and discretionary bonuses to executive officers based on the amount of the shortfall. The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019).

The Corporation's capital ratios, book value per share and tangible book value per share as of September 30, 2016 and December 31, 2015 are as follows:

|  | September 30, 2016 | December 31, 2015 |
|--|--------------------|-------------------|
| Total risk-based capital ratio             | 14.11%             | 13.18%            |
| Tier 1 capital ratio                       | 10.52%             | 12.14%            |
| Tier 1 common equity ratio                 | 9.43%              | 10.90%            |
| Leverage ratio                             | 7.71%              | 8.73%             |
| Tangible common equity/tangible assets (1) | 6.94%              | 7.64%             |
| Book value per share                       | \$ 14.90           | \$ 14.01          |
| Tangible book value per share (1)          | \$ 11.98           | \$ 11.96          |

- (1) Tangible common equity, tangible assets and tangible book value per share are non-GAAP financial measures calculated using GAAP amounts. Tangible common equity is calculated by excluding the balance of goodwill and core deposit intangibles from the calculation of shareholders' equity. Tangible assets is calculated by excluding the balance of goodwill and core deposit intangibles from the calculation of total assets. Tangible book value per share is calculated by dividing tangible common equity by the number of shares outstanding. The Corporation believes that these non-GAAP financial measures provide information to investors that is useful in understanding its financial condition because they are additional measures used to assess capital adequacy. Because not all companies use the same calculation of tangible common equity and tangible assets, this presentation may not be comparable to other similarly titled measures calculated by other companies. A reconciliation of these non-GAAP financial measures is provided below (dollars in thousands, except share and per share data).

|                              | September 30, 2016 | December 31, 2015 |
|------------------------------|--------------------|-------------------|
| Shareholders' equity         | \$ 215,489         | \$ 201,913        |
| Less goodwill                | 38,967             | 27,194            |
| Less core deposit intangible | 3,200              | 2,395             |
| Tangible common equity       | \$ 173,322         | \$ 172,324        |
| Total assets                 | \$ 2,539,944       | \$ 2,285,136      |
| Less goodwill                | 38,967             | 27,194            |
| Less core deposit intangible | 3,200              | 2,395             |

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|  |    |            |    |            |
|--|----|------------|----|------------|
| Tangible assets                        | \$ | 2,497,777  | \$ | 2,255,547  |
| Ending shares outstanding              |    | 14,465,210 |    | 14,408,430 |
| Tangible book value per share          | \$ | 11.98      | \$ | 11.96      |
| Tangible common equity/tangible assets |    | 6.94%      |    | 7.64%      |

**Table of Contents****LIQUIDITY**

Liquidity measures an organization's ability to meet cash obligations as they come due. The consolidated statement of cash flows provides analysis of the Corporation's cash and cash equivalents. Additionally, management considers that portion of the loan and investment portfolio that matures within one year to be part of the Corporation's liquid assets. The Corporation's liquidity is monitored by both management and the ALCO, which establishes and monitors ranges of acceptable liquidity. Management believes the Corporation's current liquidity position is acceptable.

**OFF BALANCE SHEET ACTIVITIES**

Some financial instruments, such as loan commitments, credit lines, letters of credit and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off balance sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

The contractual amount of financial instruments with off balance sheet risk was as follows at September 30, 2016 and December 31, 2015 (in thousands):

|                           | September 30, 2016 |               | December 31, 2015 |               |
|---------------------------|--------------------|---------------|-------------------|---------------|
|                           | Fixed Rate         | Variable Rate | Fixed Rate        | Variable Rate |
| Commitments to make loans | \$ 31,702          | \$ 235,246    | \$ 42,803         | \$ 259,032    |
| Unused lines of credit    | 0                  | 103,152       | 0                 | 87,493        |
| Standby letters of credit | 0                  | 7,699         | 0                 | 15,704        |

Commitments to make loans are generally made for periods of 60 days or less. The fixed rate loan commitments at September 30, 2016 have interest rates ranging from 1.19% to 18.00% and maturities ranging from 3 months to 20 years. The fixed rate loan commitments at December 31, 2015 have interest rates ranging from 1.19% to 18.00% and maturities ranging from 3 months to 20 years.

In October 2015, the Corporation entered into a subscription agreement with Oxer BCP Mezzanine Fund, LP (Oxer) and committed to invest \$5,000 as a limited partner in the fund. Oxer is a Small Business Investment Company (SBIC) that is licensed and regulated by the Office of Investment at the Small Business Administration (SBA). The SBIC license allows SBICs to employ private capital and funds borrowed at a low cost using SBA-guaranteed securities to make investments in qualifying small businesses and similar enterprises as defined by SBA regulations. As of September 30, 2016, the Corporation has invested \$1,338 of its \$5,000 commitment.

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**RESULTS OF OPERATIONS**

**Three Months Ended September 30, 2016 and 2015**

**OVERVIEW OF THE INCOME STATEMENT**

The Corporation had net income of \$6.4 million in the third quarter of 2016 and \$5.5 million in the third quarter of 2015. The earnings per diluted share were \$0.44 in the third quarter of 2016 and \$0.38 in the third quarter of 2015. Earnings in the third quarter of 2016 were impacted by merger costs of \$266 thousand. The annualized return on assets and return on equity for the third quarter of 2016 are 1.01% and 11.92% compared to 0.98% and 11.08% for the third quarter of 2015.

**INTEREST INCOME AND EXPENSE**

Net interest margin on a fully tax equivalent basis was 3.88% for the three months ended September 30, 2016, compared to 3.75% for the three months ended September 30, 2015. Net interest income increased by 15.2% from \$19.0 million for the three months ended September 30, 2015 to \$21.9 million for the three months ended September 30, 2016. The Corporation's net interest margin has stabilized in 2016 as the Corporation continues to use cash flows from its available-for-sale securities portfolio and core deposit growth, supplemented by short-term borrowings as needed, to fund loan growth.

**PROVISION FOR LOAN LOSSES**

The Corporation recorded a provision for loan losses of \$622 thousand in the third quarter of 2016 compared to \$463 thousand in the third quarter of 2015. Net chargeoffs in the third quarter of 2016 were \$907 thousand, compared to net chargeoffs of \$731 thousand in the third quarter of 2015. The increase in chargeoffs was primarily attributable to consumer loans held in CNB's consumer discount company, Holiday Financial Services Corporation.

Management believes the provision for loan losses was appropriate and the allowance for loan losses is adequate to absorb probable incurred losses in our portfolio as of September 30, 2016.

**NON-INTEREST INCOME AND EXPENSES**

Non-interest income was \$4.5 million for the quarter ended September 30, 2016, compared to \$4.0 million for the quarter ended September 30, 2015.

Total non-interest expenses were \$17.1 million during the three months ended September 30, 2016, compared to \$15.0 million during the three months ended September 30, 2015.

Salaries and benefits expenses increased \$934 thousand, or 12.3%, during the three months ended September 30, 2016 compared to the three months ended September 30, 2015. As of September 30, 2016, the Corporation had 471 full-time equivalent staff, compared to 430 full-time equivalent staff as of September 30, 2015. The staff added during this period included both customer-facing personnel such as business development and wealth management officers, as well as support department personnel. In addition, CNB retained 20 employees in connection with the acquisition of Lake National Bank.

Visa check card expenses of \$587 thousand and \$579 thousand during the three months ended September 30, 2016 and September 30, 2015, respectively, were reclassified as a reduction of other non-interest income to non-interest expense.

**INCOME TAX EXPENSE**

Income tax expense was \$2.3 million in the third quarter of 2016 and \$2.0 million in the third quarter of 2015, resulting in effective tax rates of 26.1% and 27.0% for the periods, respectively. The effective rates for the periods differed from the federal statutory rate of 35.0% principally as a result of tax exempt income from securities and loans as well as earnings from bank owned life insurance.

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## CONSOLIDATED YIELD COMPARISONS

## AVERAGE BALANCES AND NET INTEREST MARGIN FOR THE NINE MONTHS ENDED

Dollars in thousands

|   | September 30, 2016  |             |                    | September 30, 2015  |             |                    |
|---|---------------------|-------------|--------------------|---------------------|-------------|--------------------|
|   | Average Balance     | Annual Rate | Interest Inc./Exp. | Average Balance     | Annual Rate | Interest Inc./Exp. |
| <b>ASSETS:</b>                              |                     |             |                    |                     |             |                    |
| Securities:                                 |                     |             |                    |                     |             |                    |
| Taxable (1)                                 | \$ 403,672          | 2.36%       | \$ 7,026           | \$ 499,639          | 2.30%       | \$ 8,542           |
| Tax-Exempt (1,2)                            | 126,036             | 4.22%       | 3,855              | 136,550             | 4.31%       | 4,301              |
| Equity Securities (1,2)                     | 19,207              | 3.92%       | 564                | 12,981              | 6.80%       | 662                |
| Total securities                            | 548,915             | 2.80%       | 11,445             | 649,170             | 2.81%       | 13,505             |
| Loans:                                      |                     |             |                    |                     |             |                    |
| Commercial (2)                              | 505,316             | 4.79%       | 18,146             | 447,126             | 4.80%       | 16,093             |
| Mortgage (2)                                | 1,087,788           | 4.46%       | 36,387             | 909,549             | 4.70%       | 32,086             |
| Consumer                                    | 84,450              | 9.27%       | 5,874              | 72,215              | 10.46%      | 5,664              |
| Total loans (3)                             | 1,677,554           | 4.80%       | 60,407             | 1,428,890           | 5.02%       | 53,843             |
| Total earning assets                        | \$ 2,226,469        | 4.31%       | \$ 71,852          | 2,078,060           | 4.34%       | \$ 67,348          |
| Non interest-bearing assets:                |                     |             |                    |                     |             |                    |
| Cash and due from banks                     | 30,816              |             |                    | 27,323              |             |                    |
| Premises and equipment                      | 42,179              |             |                    | 37,236              |             |                    |
| Other assets                                | 103,151             |             |                    | 94,684              |             |                    |
| Allowance for loan losses                   | (16,431)            |             |                    | (17,650)            |             |                    |
| Total non interest-bearing assets           | 159,715             |             |                    | 141,593             |             |                    |
| <b>TOTAL ASSETS</b>                         | <b>\$ 2,386,184</b> |             |                    | <b>\$ 2,219,653</b> |             |                    |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY:</b> |                     |             |                    |                     |             |                    |
| Demand interest-bearing                     | \$ 505,620          | 0.35%       | \$ 1,330           | \$ 453,604          | 0.35%       | \$ 1,198           |
| Savings                                     | 952,091             | 0.46%       | 3,307              | 947,291             | 0.50%       | 3,559              |
| Time  | 208,164             | 1.06%       | 1,651              | 199,388             | 1.09%       | 1,624              |
| Total interest-bearing deposits             | 1,665,875           | 0.50%       | 6,288              | 1,600,283           | 0.53%       | 6,381              |
| Short-term borrowings                       | 105,809             | 0.62%       | 493                | 47,170              | 0.24%       | 86                 |
| Long-term borrowings                        | 87,010              | 2.83%       | 1,848              | 75,608              | 4.19%       | 2,378              |
| Subordinated debentures                     | 20,620              | 3.82%       | 590                | 20,620              | 3.62%       | 560                |
| Total interest-bearing liabilities          | 1,879,314           | 0.65%       | \$ 9,219           | 1,743,681           | 0.72%       | \$ 9,405           |
| Demand non interest-bearing                 | 262,728             |             |                    | 256,083             |             |                    |
| Other liabilities                           | 32,779              |             |                    | 23,682              |             |                    |

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|   |                     |           |                     |           |
|---|---------------------|-----------|---------------------|-----------|
| Total liabilities                                 | 2,174,821           |           | 2,023,446           |           |
| Shareholders' equity                              | 211,363             |           | 196,207             |           |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b> | <b>\$ 2,386,184</b> |           | <b>\$ 2,219,653</b> |           |
| Interest income/Earning assets                    | 4.31%               | \$ 71,852 | 4.34%               | \$ 67,348 |
| Interest expense/Interest-bearing liabilities     | 0.65%               | 9,219     | 0.72%               | 9,405     |
| Net interest spread                               | 3.66%               | \$ 62,633 | 3.62%               | \$ 57,943 |
| Interest income/Earning assets                    | 4.31%               | \$ 71,852 | 4.34%               | 67,348    |
| Interest expense/Earning assets                   | 0.55%               | 9,219     | 0.60%               | 9,405     |
| Net interest margin                               | 3.76%               | \$ 62,633 | 3.74%               | \$ 57,943 |

- (1) Includes unamortized discounts and premiums. Average balance is computed using the carrying value of securities. The average yield has been computed using the historical amortized cost average balance for available for sale securities.
- (2) Average yields are stated on a fully taxable equivalent basis.
- (3) Average outstanding includes the average balance outstanding of all non-accrual loans. Loans consist of the average of total loans less average unearned income. The amount of loan fees included in the interest income on loans is not material.

**Table of Contents****Nine Months Ended September 30, 2016 and 2015****OVERVIEW OF THE INCOME STATEMENT**

The Corporation had net income of \$15.5 million in the nine months ended September 30, 2016 compared to \$16.7 for the same period of 2015. The earnings per diluted share were \$1.07 for the nine months ended September 30, 2016 and \$1.16 for the nine months ended September 30, 2015. Earnings in 2016 were impacted by a prepayment penalty on the early payoff of long-term borrowings of \$1.5 million, core processing conversion costs of \$1.6 million, merger costs of \$481 thousand, and realized gains on the sale of available-for-sale securities of \$1.0 million. The annualized return on assets and return on equity for the nine months ended September 30, 2016 are 0.87% and 9.78% compared to 1.00% and 11.34%, respectively for the same period of 2015.

**INTEREST INCOME AND EXPENSE**

Net interest margin on a fully tax equivalent basis was 3.76% for the nine months ended September 30, 2016, compared to 3.74% for the nine months ended September 30, 2015. Net interest income increased by 8.1% from \$55.8 million for the nine months ended September 30, 2015 to \$60.3 million for the nine months ended September 30, 2016. The Corporation's net interest margin has stabilized in 2016 as the Corporation continues to use cash flows from its available-for-sale securities portfolio and core deposit growth, supplemented by short-term borrowings as needed, to fund loan growth.

**PROVISION FOR LOAN LOSSES**

The Corporation recorded a provision for loan losses of \$2.0 million in the nine months ended September 30, 2016, compared to \$1.9 million in the nine months ending September 30, 2015. Net chargeoffs for the nine months ended September 30, 2016 were \$3.1 million, compared to net chargeoffs of \$2.0 million in the same period of 2015. The increase in chargeoffs was primarily attributable to consumer loans held in CNB's consumer discount company, Holiday Financial Services Corporation. Resulting increases in the provision for loan losses in the consumer lending portfolio were offset by a decrease in the general loan loss reserves required in 2016 due to lower historical loss rates in the commercial & industrial, commercial real estate, and residential real estate portfolio segments.

Management believes the provision for loan losses was appropriate and the allowance for loan losses is adequate to absorb probable incurred losses in our portfolio as of September, 2016.

**NON-INTEREST INCOME AND EXPENSES**

Non-interest income was \$13.1 million for the nine months ended September 30, 2016, compared to \$12.4 million for the nine months ended September 30, 2015. In 2016, the Corporation realized gains on the sale of available-for-sale securities in the amount of \$1.0 million, including \$922 thousand on the sale of two structured pooled trust preferred securities that had no carrying value due to other-than-temporary impairment charges recorded in previous periods. Net realized gains on the sale of available-for-sale securities in 2015 were \$564 thousand.

Total non-interest expenses were \$50.7 million during the nine months ended September 30, 2016, compared to \$43.4 million during the nine months ended September 30, 2015. Throughout 2015 and the first nine months of 2016, CNB made numerous infrastructure, personnel, and other investments to facilitate its continued growth. In order to better serve our customers and to achieve operational efficiencies, CNB completed a core processing system upgrade in May 2016. Included in non-interest expenses in 2016 were merger related expenses of \$481 thousand, costs associated with our core processing system upgrade of \$1.6 million, and a prepayment penalty associated with the early payoff of long-term borrowings of \$1.5 million. The borrowings totaled \$40 million and carried interest rates ranging from 3.97% to 4.60%, and the resulting interest expense savings for 2016 and 2017 will total \$1.9 million.

Salaries and benefits expenses increased \$2.2 million, or 10.1%, during the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015. As of September 30, 2016, the Corporation had 471 full-time equivalent staff, compared to 430 full-time equivalent staff as of September 30, 2015. The staff added during this period included both customer-facing personnel such as business development and wealth management officers, as well as support department personnel. In addition, CNB retained 20 employees in connection with the acquisition of Lake National Bank.

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Visa check card expenses of \$1.7 million during the nine months ended September 30, 2016 and September 30, 2015, were reclassified as a reduction of other non-interest income to non-interest expense.

### **INCOME TAX EXPENSE**

Income tax expense was \$5.1 million for the nine months ended September 30, 2016 as compared to \$6.2 million for the nine months ended September 30, 2015, resulting in effective tax rates of 24.9% and 27.1% for the periods, respectively. The effective rates for the periods differed from the federal statutory rate of 35.0% principally as a result of tax exempt income from securities and loans, earnings from bank owned life insurance, and nondeductible merger costs.

### **CRITICAL ACCOUNTING POLICIES**

The Corporation's accounting and reporting policies are in accordance with GAAP and conform to general practices within the financial services industry. Accounting and reporting practices for the allowance for loan losses and fair value of securities are deemed critical since they involve the use of estimates and require significant management judgments. In addition, the fair value of assets acquired and liabilities assumed in connection with business combinations, including the associated goodwill that was recorded, required the use of material estimates. Application of assumptions different than those used by management could result in material changes in the Corporation's financial position or results of operations. Note 1 (Summary of Significant Accounting Policies), Note 2 (Business Combination), Note 4 (Securities), and Note 5 (Loans) of the Corporation's 2015 Form 10-K, provide detail with regard to the Corporation's accounting for the allowance for loan losses, the fair value of securities, business combinations and loans. There have been no significant changes in the application of accounting policies since December 31, 2015.

### **ITEM 3**

### **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

As a financial institution, the Corporation's primary source of market risk is interest rate risk, which is the exposure to fluctuations in the Corporation's future earnings resulting from changes in interest rates. This exposure is correlated to the repricing characteristics of the Corporation's portfolio of assets and liabilities. Each asset or liability reprices either at maturity or during the life of the instrument.

The principal purpose of asset/liability management is to maximize current and future net interest income within acceptable levels of interest rate risk while satisfying liquidity and capital requirements. Net interest income is enhanced by increasing the net interest margin and by the growth in earning assets. As a result, the primary goal of interest rate risk management is to maintain a balance between risk and reward such that net interest income is maximized while risk is maintained at an acceptable level.

The Corporation uses an asset-liability management model to measure the effect of interest rate changes on its net interest income. The Corporation's management also reviews asset-liability maturity gap and repricing analyses regularly. The Corporation does not always attempt to achieve a precise match between interest sensitive assets and liabilities because it believes that an actively managed amount of interest rate risk is inherent and appropriate in the management of the Corporation's profitability.

Asset-liability modeling techniques and simulation involve assumptions and estimates that inherently cannot be measured with precision. Key assumptions in these analyses include maturity and repricing characteristics of assets and liabilities, prepayments on amortizing assets, non-maturing deposit sensitivity, and loan and deposit pricing. These assumptions are inherently uncertain due to the timing, magnitude, and frequency of rate changes and changes in market conditions and management strategies, among other factors. However, the analyses are useful in quantifying risk and provide a relative gauge of the Corporation's interest rate risk position over time.

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Management reviews interest rate risk on a quarterly basis and reports to the ALCO. This review includes earnings shock scenarios whereby interest rates are immediately increased and decreased by 100, 300, and 400 basis points. These scenarios, detailed in the table below, indicate that there would not be a significant variance in net interest income over a one-year period due to interest rate changes; however, actual results could vary significantly. Based on the most recent data available as of June 30, 2016, all interest rate risk levels according to the model were within the tolerance limits of ALCO approved policy of +/- 25%. In addition, the table does not take into consideration changes that management would make to realign its assets and liabilities in the event of an unexpected change in the interest rate environment. Due to the historically low interest rate environment, the -300 and -400 scenarios have been excluded from the table.

| Change in    | June 30, 2016 | % Change in Net |
|--------------|---------------|-----------------|
| Basis Points |               | Interest Income |
| 400          |               | 7.2%            |
| 300          |               | 6.0%            |
| 100          |               | 2.8%            |
| (100)        |               | (2.5%)          |

**ITEM 4****CONTROLS AND PROCEDURES**

As of the end of the period covered by this quarterly report, an evaluation was carried out under the supervision and with the participation of the Corporation's management, including the Chief Executive Officer and Principal Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934) ( Exchange Act ). Based on their evaluation, our Chief Executive Officer and Principal Financial Officer have concluded that the Corporation's disclosure controls and procedures were effective as of the end of the period covered by this quarterly report to ensure that information required to be disclosed by the Corporation in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms. There were no changes in the Corporation's internal control over financial reporting that occurred during the period covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

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**PART II OTHER INFORMATION**

ITEM 1. LEGAL PROCEEDINGS None

ITEM 1A. RISK FACTORS There have been no material changes to the risk factors disclosed in Part I, Item 1A of the 2015 Form 10-K.

**ITEM 6. EXHIBITS**

| Exhibit No. | Description   |
|-------------|---|
| 2.1         | Agreement and Plan of Merger, dated as of December 29, 2015, by and between the Corporation, the Bank and Lake National Bank, filed with the SEC as Exhibit 2.1 to the Corporation's Current Report on Form 8-K filed on December 30, 2015, and incorporated herein by reference. |
| 3.1         | Amended and Restated Articles of Incorporation of the Corporation, filed as Appendix B to the 2006 Proxy Statement, filed with the SEC on March 24, 2006, and incorporated herein by reference.   |
| 3.2         | By-Laws of the Corporation, as amended and restated, filed as Appendix C to the 2006 Proxy Statement, filed with the SEC on March 24, 2006, and incorporated herein by reference.   |
| 31.1        | Rule 13a-14(a)/15d-14(a) Certification of the Principal Executive Officer   |
| 31.2        | Rule 13a-14(a)/15d-14(a) Certification of the Principal Financial Officer   |
| 32.1        | Section 1350 Certification  |
| 32.2        | Section 1350 Certification  |
| 101.INS     | XBRL Instance Document  |
| 101.SCH     | XBRL Taxonomy Extension Schema Document   |
| 101.CAL     | XBRL Taxonomy Extension Calculation Linkbase Document   |
| 101.DEF     | XBRL Taxonomy Extension Definitions Linkbase Document   |
| 101.LAB     | XBRL Taxonomy Extension Label Linkbase Document   |
| 101.PRE     | XBRL Taxonomy Extension Presentation Linkbase Document  |

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**SIGNATURES**

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

CNB FINANCIAL CORPORATION  
(Registrant)

DATE: November 3, 2016

/s/ Joseph B. Bower, Jr.  
Joseph B. Bower, Jr.  
President and Director  
(Principal Executive Officer)

DATE: November 3, 2016

/s/ Brian W. Wingard  
Brian W. Wingard  
Treasurer  
(Principal Financial Officer)

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