

April 9, 2013

Dear Shareholder:

The New Year brings exciting change. With your approval, we will change our holding company name to Truxton Corporation. Your management and the Board of Directors have approved a concurrent change of the bank's name from Nashville Bank and Trust Company to Truxton Trust Company. We love Nashville; most of us are lifelong residents. But we want an identity that travels beyond the Cumberland Valley, which welcomes affluent partners and clients from throughout the larger region. We also want to remove the name confusion that we currently have with other banks in Middle Tennessee. We're rooted right here, but feel certain that you, our shareholders, will be best-served by a name that supports our growth.

Our company and its operating subsidiary Nashville Bank and Trust enjoyed another year of growth and increased profitability in 2012. Net interest income after provision for loan losses grew to \$8.5 million, up 10.5% from 2011. Non interest income increased 25.1% to \$4.8 million. Net income rose by 43.8%, reaching almost \$2.9 million. Fully diluted earnings per share climbed to \$1.26 from \$0.89 a year ago. Total assets increased by 24.1% in 2012 to \$300.3 million. Deposits grew by 27.6% during 2012 to \$252.1 million while the bank's net loans increased by 12.4% to \$187.8 million.

In 2012, our Trust and Wealth Management business continued its strong and steady growth. Revenue in this business increased by 20.0% to \$4.2 million and comprised most of our non-interest income. We continue to win new wealth management business from people who need quality asset management and the comprehensive services we offer.

We ended the year with a solid capital position. Our Tier 1 leverage ratio in the bank was 9.50%, a strong level that supports our steady asset growth. We returned 10.6% on average equity capital for the year after earning 8.3% in 2011. Continuing to grow our returns on equity capital is among our highest priorities for the coming years. The assets of the bank exceeded \$300 million for the first time and the assets in our Wealth Management business exceeded \$540 million at year end. We accomplished this growth without compromise to our asset quality which remained superb at the end of 2012. This year will present major challenges as we work to maintain margins in a very low interest rate environment.

The economy should grow moderately in 2013; and business confidence should continue to improve. Interest rates have already risen in the New Year but remain near historic lows. Deposit rates – the prices we pay for our funds – are unlikely to decline further, but our new fixed rate loans are made at lower rates than our old loans. The result is pressure on net interest margin, the second most important factor in the success of our banking business behind credit quality. We plan to continue our earnings growth next year, but this headwind will make it difficult.

Our wealth management business should grow as it always has -- one relationship at a time. But we will also seek to expand the reach and breadth of our services by carefully considering new service offerings and potential acquisitions. We thank you again for your continued support.



Charles W. Cook, Jr.  
Chairman of the Board



Thomas S. Stumb  
President and Chief Executive Officer



**NBT HOLDINGS INC. AND SUBSIDIARY**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2012 and 2011**

**NBT HOLDINGS INC. AND SUBSIDIARY**  
**Nashville, Tennessee**

**CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2012 and 2011**

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## INDEPENDENT AUDITOR'S REPORT

The Board of Directors  
NBT Holdings Inc. and Subsidiary  
Nashville, Tennessee

### **Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of NBT Holdings Inc. and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of net income, comprehensive income, and changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

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

### ***Auditor's Responsibility***

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

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

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

### ***Opinion***

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



Crowe Horwath LLP

Brentwood, Tennessee  
February 25, 2013

**NBT HOLDINGS INC. AND SUBSIDIARY**  
**CONSOLIDATED BALANCE SHEETS**  
December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
<b>ASSETS</b>		
Cash and due from financial institutions	\$ 6,296,366	\$ 5,687,987
Interest bearing deposits in other financial institutions	1,333,971	9,630,940
Federal funds sold	<u>10,519,537</u>	<u>3,360,810</u>
Cash and cash equivalents	18,149,874	18,679,737
Time deposits in other financial institutions	10,201,000	12,368,000
Securities available for sale	73,746,869	39,859,082
Gross loans	190,682,963	169,663,316
Allowance for loan losses	<u>(2,910,896)</u>	<u>(2,546,333)</u>
Net loans	187,772,067	167,116,983
Bank owned life insurance	6,106,054	-
Restricted equity securities	1,872,500	1,866,350
Premises and equipment, net	856,980	212,117
Accrued interest receivable	859,694	718,984
Prepaid long-term compensation	64,333	192,416
Prepaid FDIC insurance assessments	172,068	286,779
Deferred tax asset, net	192,895	375,204
Other assets	<u>318,870</u>	<u>284,586</u>
Total assets	<u>\$ 300,313,204</u>	<u>\$ 241,960,238</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits		
Non-interest bearing	\$ 63,175,324	\$ 41,934,771
Interest bearing	<u>188,933,332</u>	<u>155,591,055</u>
Total deposits	252,108,656	197,525,826
Federal Home Loan Bank advances	17,738,260	17,343,000
Accrued interest payable	17,528	25,216
Other liabilities	<u>1,298,762</u>	<u>1,469,458</u>
Total liabilities	271,163,206	216,363,500
Shareholders' equity		
Preferred stock, \$0.10 par value; 5,000,000 shares authorized; no shares issued	-	-
Common stock, \$0.10 par value; 40,000,000 shares authorized; 2,247,793 shares issued in 2012 and 2,227,198 shares issued in 2011	224,780	222,720
Additional paid-in capital	21,918,897	21,706,088
Retained earnings	6,147,815	3,250,289
Accumulated other comprehensive income	<u>858,506</u>	<u>417,641</u>
Total shareholders' equity	<u>29,149,998</u>	<u>25,596,738</u>
Total liabilities and shareholders' equity	<u>\$ 300,313,204</u>	<u>\$ 241,960,238</u>

See accompanying notes to consolidated financial statements.

**NBT HOLDINGS INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF NET INCOME**  
**Years ended December 31, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
<b>Non-interest income</b>		
Wealth management services	\$ 4,200,569	\$ 3,500,790
Service charges on deposit accounts	152,542	156,711
Gain on securities	112,370	-
Bank owned life insurance income	106,054	-
Other	<u>259,631</u>	<u>204,795</u>
<b>Total non-interest income</b>	<u>4,831,166</u>	<u>3,862,296</u>
<b>Interest income</b>		
Loans, including fees	8,989,481	8,741,446
Taxable securities	763,110	455,716
Tax-exempt securities	396,865	185,829
Interest bearing deposits	155,257	249,766
Federal funds sold	<u>23,065</u>	<u>14,104</u>
<b>Total interest income</b>	<u>10,327,778</u>	<u>9,646,861</u>
<b>Interest expense</b>		
Deposits	1,119,075	1,395,623
Short-term borrowings	4,056	1,091
Long-term borrowings	<u>380,303</u>	<u>235,839</u>
<b>Total interest expense</b>	<u>1,503,434</u>	<u>1,632,553</u>
<b>Net interest income</b>	8,824,344	8,014,308
<b>Provision for loan losses</b>	<u>364,563</u>	<u>355,284</u>
<b>Net interest income after provision for loan losses</b>	<u>8,459,781</u>	<u>7,659,024</u>
<b>Total revenue, net</b>	13,290,947	11,521,320
<b>Non-interest expense</b>		
Salaries and employee benefits	6,275,163	6,035,788
Occupancy	558,696	364,779
Furniture and equipment	71,408	39,829
Data processing	639,577	523,478
Wealth management processing fees	393,930	351,885
Advertising and public relations	122,499	92,776
Professional services	418,147	295,971
FDIC insurance assessments	131,212	176,432
Other	<u>537,278</u>	<u>467,525</u>
<b>Total non-interest expense</b>	<u>9,147,910</u>	<u>8,348,463</u>
<b>Income before income taxes</b>	4,143,037	3,172,857
Income tax expense	<u>1,245,511</u>	<u>1,157,471</u>
<b>Net income</b>	<u>\$ 2,897,526</u>	<u>\$ 2,015,386</u>
Earnings per share:		
Basic	\$ 1.29	\$ 0.91
Diluted	\$ 1.26	\$ 0.89

See accompanying notes to consolidated financial statements.

**NBT HOLDINGS INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**Years ended December 31, 2012 and 2011**

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	<u>2012</u>	<u>2011</u>
<b>Net income</b>	\$ 2,897,526	\$ 2,015,386
Other comprehensive income:		
Unrealized gains/losses on securities:		
Unrealized holding gain arising during the period	826,660	678,420
Reclassification adjustment for gains included in net income	(112,370)	-
Tax effect	<u>(273,425)</u>	<u>(259,767)</u>
Total other comprehensive income, net of tax	<u>440,865</u>	<u>418,653</u>
Comprehensive income	<u>\$ 3,338,391</u>	<u>\$ 2,434,039</u>

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See accompanying notes to consolidated financial statements.



**NBT HOLDINGS INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**Years Ended December 31, 2012 and 2011**

	<u>Shares</u>	<u>Common Stock</u>	<u>Additional Paid-In Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Shareholders' Equity</u>
Balance at January 1, 2011	2,201,645	\$ 220,165	\$ 21,540,037	\$ 1,234,903	\$ (1,012)	\$ 22,994,093
Exercise of stock options	772	77	(77)	-	-	-
Issuance of restricted shares of common stock, net	24,781	2,478	(2,478)	-	-	-
Stock based compensation expense	-	-	168,606	-	-	168,606
Net income	-	-	-	2,015,386	-	2,015,386
Other comprehensive income	-	-	-	-	418,653	418,653
Balance at December 31, 2011	2,227,198	222,720	21,706,088	3,250,289	417,641	25,596,738
Exercise of stock options	1,500	150	15,600	-	-	15,750
Net settlement of stock options	-	-	(15,640)	-	-	(15,640)
Issuance of restricted shares of common stock, net	19,095	1,910	(1,910)	-	-	-
Stock based compensation expense	-	-	214,759	-	-	214,759
Net income	-	-	-	2,897,526	-	2,897,526
Other comprehensive income	-	-	-	-	440,865	440,865
Balance at December 31, 2012	<u>2,247,793</u>	<u>\$ 224,780</u>	<u>\$ 21,918,897</u>	<u>\$ 6,147,815</u>	<u>\$ 858,506</u>	<u>\$ 29,149,998</u>

See accompanying notes to consolidated financial statements.

**NBT HOLDINGS INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**Years Ended December 31, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
<b>Cash flows from operating activities</b>		
Net income	\$ 2,897,526	\$ 2,015,386
Adjustments to reconcile net income to net cash from operating activities		
Depreciation and amortization	119,859	84,013
Net amortization of securities	558,968	156,324
Deferred income tax benefit	(91,240)	(311,382)
Provision for loan losses	364,563	355,284
Gain on securities	(112,370)	-
Stock based compensation expense	214,759	168,606
Bank owned life insurance income	(106,054)	-
Net change in:		
Accrued interest receivable	(140,710)	(205,449)
Accrued interest payable	(7,688)	(31,068)
Prepaid long-term compensation	128,083	153,972
Prepaid FDIC insurance assessments	114,711	161,440
Other assets	(34,300)	(70,492)
Other liabilities	<u>(170,680)</u>	<u>324,252</u>
Net cash from operating activities	<u>3,735,427</u>	<u>2,800,886</u>
<b>Cash flows from investing activities</b>		
Net decrease in time deposits in other financial institutions	2,167,000	5,437,000
Purchase of bank owned life insurance	(6,000,000)	-
Available for sale securities:		
Purchases	(53,855,267)	(28,851,536)
Maturities, calls and paydowns	10,912,741	7,338,133
Sales	9,322,555	-
Net increase in loans	(21,019,647)	(18,145,725)
Purchase of restricted equity securities	(6,150)	(506,000)
Additions of premises and equipment, net	<u>(764,722)</u>	<u>(63,942)</u>
Net cash from investing activities	<u>(59,243,490)</u>	<u>(34,792,070)</u>
<b>Cash flows from financing activities</b>		
Proceeds from Federal Home Loan Bank advances	8,000,000	3,843,000
Repayments of Federal Home Loan Bank advances	(7,604,740)	(1,750,000)
Net increase in deposits	54,582,830	30,465,983
Proceeds from issuance of common stock	15,750	-
Net settlement of stock options	<u>(15,640)</u>	<u>-</u>
Net cash from financing activities	<u>54,978,200</u>	<u>32,558,983</u>
Net change in cash and cash equivalents	(529,863)	567,799
Cash and cash equivalents at beginning of year	<u>18,679,737</u>	<u>18,111,938</u>
Cash and cash equivalents at end of year	<u>\$ 18,149,874</u>	<u>\$ 18,679,737</u>
Supplemental cash flow information:		
Cash paid during year for interest	\$ 1,511,122	\$ 1,663,621
Cash paid during year for income taxes	1,362,595	1,381,133

See accompanying notes to consolidated financial statements.

**NBT HOLDINGS INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2012 and 2011**

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Nature of Operations and Principals of Consolidation: The consolidated financial statements include NBT Holdings Inc. and its wholly owned subsidiary, Nashville Bank and Trust Company “the “Bank,” together referred to as “the Corporation.” Intercompany transactions and balances are eliminated in consolidation.

The Bank received its charter as a state bank with trust powers and began operating on August 30, 2004. During July 2009, NBT Holdings Inc. was formed and the existing shares of common stock for Nashville Bank and Trust Company were acquired and exchanged for common shares in NBT Holdings Inc. The Bank represents substantially all the operations in the consolidated financial statements and it provides a variety of banking, investment management and trust administration services to individuals, businesses and charitable institutions. Its primary deposit products are demand, money market and certificates of deposit and its primary lending products are residential and commercial real estate mortgages, commercial loans and loans to individuals.

Subsequent Events: The Corporation has evaluated subsequent events for recognition and disclosure through February 25, 2013, which is the date the financial statements were available to be issued.

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

Cash Flows: Cash and cash equivalents include cash, deposits with other financial institutions with maturities under 90 days, and federal funds sold. Net cash flows are reported for customer loan and deposit transactions, and time deposits in other financial institutions.

Interest-Bearing Deposits in Other Financial Institutions: Interest-bearing deposits in other financial institutions mature within one year and are carried at cost.

Time Deposits in Other Financial Institutions: Time deposits in other financial institutions are carried at cost. These accounts are maintained at several financial institutions and are all within the insurance limits provided by the Federal Deposit Insurance Corporation and have maturities ranging from 2013 to 2015.

Securities: Debt securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value with unrealized holding gains and losses reported in accumulated other comprehensive income (loss), net of tax.

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

Management evaluates securities for other-than-temporary impairment “OTTI” on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement, and 2) OTTI related to other factors, which is recognized in other comprehensive income(loss). The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

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**NBT HOLDINGS INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2012 and 2011**

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method without anticipating prepayments.

Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term. Interest income on all loans is discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

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

Concentration of Credit Risk: Most of the Corporation's business activity is with customers located within Nashville, Tennessee. Therefore, the Corporation's exposure to credit risk is significantly affected by changes in the economy in the Nashville, Tennessee metropolitan area.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and decreased by charge-offs less recoveries. Management estimates the allowance balance required using historical loan loss experience of both the bank and the banking industry, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

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

A loan is impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans, for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Commercial and commercial real estate loans are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans are collectively evaluated for impairment and accordingly, they are not separately identified for impairment disclosures.

**NBT HOLDINGS INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2012 and 2011**

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Troubled debt restructurings are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Corporation determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The historical loss experience used in management's analysis of the general component for the allowance for loan losses is determined by portfolio segment and is based on the average loss history experienced by the banking industry over the most recent 10 years. The Corporation used the loss history of its peers, as it has not experienced any losses on its own during the entire history of the Corporation. Management used a 10 year period of peer losses in order to align with what management expects normalized probable incurred losses to be for the Corporation. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments have been identified:

- Commercial loans include loans for commercial, industrial or agricultural purposes to business enterprises that are not secured by real estate. These loans are typically made on the basis of the borrower's ability to repay from the cash flow of the borrower's business and are generally secured by accounts receivable, inventory and equipment. The collateral securing loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business.
- Commercial Real Estate loans include loans secured by non-residential real estate and improvements thereon. Often these loans are made to single borrowers or groups of related borrowers, and the repayment of these loans largely depends on the results of operations and management of these properties. Adverse economic conditions may affect the repayment ability of these loans.
- Residential Real Estate loans include loans secured by residential real estate, including single-family and multi-family dwellings. Adverse economic conditions in the Corporation's market area may reduce borrowers' ability to repay these loans and may reduce the collateral securing these loans.
- Construction and Land Development loans include loans to finance the process of improving properties preparatory to erecting new structures or the on-site construction of industrial, commercial, residential or farm buildings. Construction and land development loans also include loans secured by vacant land, except land known to be used or usable for agricultural purposes. Construction loans generally are made for relatively short terms. They generally are more vulnerable to changes in economic conditions. Furthermore, the nature of these loans is such that they are more difficult to evaluate and monitor. The risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property's value upon completion of the project and the estimated cost (including interest) of the project. Periodic site inspections are made on construction loans.
- Consumer loans include loans to individuals for household, family and other personal expenditures that are not secured by real estate.

Bank Owned Life Insurance: The Company has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

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**NBT HOLDINGS INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2012 and 2011**

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

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

Premises and Equipment: Premises and equipment are stated at cost less accumulated depreciation. Leasehold improvements are amortized using the straight-line method over the shorter of the lease terms or the useful lives. Furniture, fixtures and equipment are depreciated using the straight-line method with useful lives ranging from three to five years.

Restricted Equity Securities: The Corporation is a member of the Federal Home Loan Bank "FHLB" and Federal Reserve Bank "FRB" systems. Members are required to own a certain amount of stock based on the level of borrowings and on their level of equity and may invest in additional amounts. FHLB and FRB stock are carried at cost, classified as restricted equity securities and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Prepaid Long-term Compensation: The Corporation paid retention bonuses in cash to certain key employees. These cash bonuses are considered long-term compensation to be earned over a 36 to 60 month requisite service period. The amount of the contracts is earned prorata by the employees and expensed prorata by the Corporation over the contractual term of the agreements. In the event that the employee leaves during the life of the contract, the employee is obligated to repay the unearned amount.

Long-term Assets: Premises and equipment and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Assets Under Management: Assets held in fiduciary or agency capacities are not included in the consolidated balance sheets, since such items are not assets of the Corporation.

Wealth Management Services Income Recognition: Income from Wealth Management Services is calculated by multiplying each investment management account's market value, determined on a specific date each month, by a static or tiered percentage, according to the investment management agreement. The income resulting from Wealth Management Services accounts is recognized monthly.

Stock-Based Compensation: Compensation cost is recognized for stock options and restricted stock awards issued to employees and directors, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Corporation's common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Retirement Plans: Employee 401(k) benefit plan expense is the amount of matching contributions for the period.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale which are also recognized as separate components of shareholders' equity.

**NBT HOLDINGS INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2012 and 2011**

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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

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

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

The Corporation recognizes interest and/or penalties related to income tax matters in income tax expense.

Earnings Per Share: Basic earnings per share available to common shareholders is computed by dividing net income adjusted for income allocated to participating securities by the weighted average number of common shares outstanding during the period. All outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends are considered participating securities for this calculation. Diluted earnings per share include the dilutive effect of additional potential common shares issuable under stock options.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe that there now are such matters that will have a material effect on the financial statements.

Restrictions on Cash: Cash on hand or on deposit with the Federal Reserve Bank is required to meet regulatory reserve and clearing requirements.

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the Corporation or by the Corporation to shareholders.

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Off Balance Sheet Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and standby letters of credit issued to meet customer financing needs. The face amount for these items represents the exposure to loss before considering customer collateral or ability to repay. Such financial instruments are recorded as loans when they are funded.

Reclassifications: Some items in the prior year financial statements were reclassified to conform to current presentation. Reclassification had no effect on prior year net income or shareholders' equity.

**NBT HOLDINGS INC. AND SUBSIDIARY**  
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**December 31, 2012 and 2011**

**NOTE 2 - SECURITIES**

The following table summarizes the amortized cost and fair value of the available for sale securities portfolio at December 31, 2012 and 2011 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income (loss):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>2012</b>				
Available for sale				
U.S. government sponsored entities and agencies	\$ 4,960,865	\$ 2,009	\$ (28,938)	\$ 4,933,936
Corporate bonds	4,820,375	163,319	-	4,983,694
State and political subdivisions	18,550,422	815,829	(15,054)	19,351,197
Collateralized mortgage obligations	6,230,798	25,780	(14,014)	6,242,564
Mortgage-backed securities: residential	16,630,644	241,548	(7,137)	16,865,055
Mortgage-backed securities: commercial	<u>21,162,571</u>	<u>229,364</u>	<u>(21,512)</u>	<u>21,370,423</u>
Total available for sale	<u>\$ 72,355,675</u>	<u>\$ 1,477,849</u>	<u>\$ (86,655)</u>	<u>\$ 73,746,869</u>
<b>2011</b>				
Available for sale				
U.S. government sponsored entities and agencies	\$ 4,156,323	\$ 53,887	\$ -	\$ 4,210,210
Corporate bonds	5,270,969	156,827	(133,037)	5,294,759
State and political subdivisions	10,447,181	509,161	(3,961)	10,952,381
Collateralized mortgage obligations	1,622,661	1,934	(24,169)	1,600,426
Mortgage-backed securities: residential	10,673,623	126,010	(2,535)	10,797,098
Mortgage backed securities: commercial	<u>7,011,546</u>	<u>75</u>	<u>(7,413)</u>	<u>7,004,208</u>
Total available for sale	<u>\$ 39,182,303</u>	<u>\$ 847,894</u>	<u>\$ (171,115)</u>	<u>\$ 39,859,082</u>

Sales of available for sale securities were as follows:

	<u>2012</u>	<u>2011</u>
Proceeds	\$ 9,322,555	\$ -
Gross gains	125,872	-
Gross losses	(13,502)	-

Securities pledged at year-end 2012 and 2011 had carry value of \$4,669,953 and \$0, and were pledged to secure public deposits. The Corporation had no holdings of securities of any one issuer, other than the U.S. government sponsored entities and agencies, in an amount greater than 10% of shareholders' equity.



**NBT HOLDINGS INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2012 and 2011**

**NOTE 2 – SECURITIES** (Continued)

The amortized cost and fair value of the investment securities portfolio are shown by contractual maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	December 31, 2012		December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within one year	\$ 162,191	\$ 161,696	\$ 5,059,214	\$ 5,239,638
One to five years	3,980,220	4,141,864	-	-
Five to ten years	14,120,086	14,628,010	9,346,881	9,504,718
Beyond ten years	10,069,165	10,337,257	5,468,378	5,712,994
Collateralized mortgage obligations	6,230,798	6,242,564	1,622,661	1,600,426
Mortgage-backed securities:				
Residential	16,630,644	16,865,055	10,673,623	10,797,098
Mortgage-backed securities:				
Commercial	<u>21,162,571</u>	<u>21,370,423</u>	<u>7,011,546</u>	<u>7,004,208</u>
<b>Total</b>	<b><u>\$ 72,355,675</u></b>	<b><u>\$ 73,746,869</u></b>	<b><u>\$ 39,182,303</u></b>	<b><u>\$ 39,859,082</u></b>

The following table summarizes the investment securities with unrealized losses at December 31, 2012 and 2011 aggregated by major security type and length of time in a continuous unrealized loss position:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>December 31, 2012</b>						
Available for sale						
U.S. government sponsored entities and agencies	\$ 4,781,699	\$ (28,938)	\$ -	\$ -	\$ 4,781,699	\$ (28,938)
State and political subdivisions	2,096,782	(15,054)	-	-	2,096,782	(15,054)
Collateralized mortgage obligation	3,007,593	(14,014)	-	-	3,007,593	(14,014)
Mortgage back securities: residential	962,199	(7,137)	-	-	962,199	(7,137)
Mortgage back securities: commercial	<u>4,129,787</u>	<u>(21,512)</u>	<u>-</u>	<u>-</u>	<u>4,129,787</u>	<u>(21,512)</u>
<b>Total available for sale</b>	<b><u>\$ 14,978,060</u></b>	<b><u>\$ (86,655)</u></b>	<b><u>\$ -</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 14,978,060</u></b>	<b><u>\$ (86,655)</u></b>
<b>December 31, 2011</b>						
Available for sale						
Corporate bonds	\$ 1,150,189	\$ (99,811)	\$ 466,774	\$ (33,226)	\$ 1,616,963	\$(133,037)
State and political subdivisions	857,055	(3,448)	123,167	(513)	980,222	(3,961)
Collateralized mortgage obligations	1,533,970	(24,169)	-	-	1,533,970	(24,169)
Mortgage back securities: residential	1,192,090	(2,535)	-	-	1,192,090	(2,535)
Mortgage back securities: commercial	<u>2,526,390</u>	<u>(7,413)</u>	<u>-</u>	<u>-</u>	<u>2,526,390</u>	<u>(7,413)</u>
<b>Total available for sale</b>	<b><u>\$ 7,259,694</u></b>	<b><u>\$(137,376)</u></b>	<b><u>\$ 589,941</u></b>	<b><u>\$ (33,739)</u></b>	<b><u>\$ 7,849,635</u></b>	<b><u>\$(171,115)</u></b>

**NBT HOLDINGS INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 2 – SECURITIES** (Continued)

Unrealized losses on securities have not been recognized into income because the issuers are of high credit quality, management does not intend to sell and it is more likely than not that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in market interest rates instead of credit quality. The fair value is expected to recover as the securities approach their maturity dates and/or market rates change. As a result, the Corporation does not consider these securities to be other-than-temporarily impaired at December 31, 2012.

Restricted equity securities consist of securities which are restricted as to transferability. These securities are recorded at cost. Restricted equity securities consist of the following at December 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Federal Home Loan Bank stock	\$ 1,221,800	\$ 1,221,800
Federal Reserve Bank stock	<u>650,700</u>	<u>644,550</u>
	<u>\$ 1,872,500</u>	<u>\$ 1,866,350</u>

**NOTE 3 - LOANS**

Loans at year end were as follows:

	<u>2012</u>	<u>2011</u>
Commercial	\$ 34,331,146	\$ 36,010,693
Commercial real estate	42,327,688	29,527,521
Residential real estate:		
Closed-end	59,395,398	54,134,103
Open-end	30,572,311	32,854,498
Construction and land development		
Owner occupied	4,466,118	2,344,330
Development	3,781,254	3,253,145
Consumer	<u>15,924,831</u>	<u>11,600,604</u>
Subtotal	190,798,746	169,724,894
Net deferred loan (fees) costs	<u>(115,783)</u>	<u>(61,578)</u>
Gross loans	<u>\$ 190,682,963</u>	<u>\$ 169,663,316</u>

**NBT HOLDINGS INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2012 and 2011

**NOTE 3 - LOANS (Continued)**

The following tables present the activity in the allowance for loan losses by portfolio segment for the year ending December 31, 2012 and 2011:

<u>December 31, 2012</u>	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate</u>	<u>Construction and Land Development</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
Allowance for loan losses:							
Beginning balance	\$ 682,027	\$ 519,673	\$ 1,001,618	\$ 102,363	\$ 115,628	\$ 125,024	\$ 2,546,333
Provision for loan losses	(98,742)	292,880	122,761	104,448	68,240	(125,024)	364,563
Loans charged-off	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-
Total ending allowance balance	<u>\$ 583,285</u>	<u>\$ 812,553</u>	<u>\$ 1,124,379</u>	<u>\$ 206,811</u>	<u>\$ 183,868</u>	<u>\$ -</u>	<u>\$ 2,910,896</u>
<u>December 31, 2011</u>	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate</u>	<u>Construction and Land Development</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
Allowance for loan losses:							
Beginning balance	\$ 654,839	\$ 337,696	\$ 775,296	\$ 169,551	\$ 115,386	\$ 138,281	\$ 2,191,049
Provision for loan losses	27,188	181,977	226,322	(67,188)	242	(13,257)	355,284
Loans charged-off	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-
Total ending allowance balance	<u>\$ 682,027</u>	<u>\$ 519,673</u>	<u>\$ 1,001,618</u>	<u>\$ 102,363</u>	<u>\$ 115,628</u>	<u>\$ 125,024</u>	<u>\$ 2,546,333</u>

**NBT HOLDINGS INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2012 and 2011

**NOTE 3 - LOANS (Continued)**

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2012 and 2011. The recorded investment amounts do not include accrued and unpaid interest or any net deferred loan fees or costs due to immateriality.

December 31, 2012	Commercial Real Estate	Residential Real Estate	Construction and Land Development	Consumer	Unallocated	Total
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	\$ -	\$ 155,375	\$ 56,425	-	-	\$ 211,800
Collectively evaluated for impairment	<u>583,285</u>	<u>812,553</u>	<u>150,386</u>	<u>183,868</u>	<u>-</u>	<u>2,699,096</u>
Total ending allowance balance	\$ 583,285	\$ 1,124,379	\$ 206,811	\$ 183,868	-	\$ 2,910,896
 Loans:						
Individually evaluated for impairment	-	\$ 489,875	\$ 56,425	-	-	\$ 546,300
Collectively evaluated for impairment	<u>34,331,146</u>	<u>42,327,688</u>	<u>8,190,947</u>	<u>15,924,831</u>	<u>-</u>	<u>190,252,446</u>
Total ending loans balance	\$ 34,331,146	\$ 89,967,709	\$ 8,247,372	\$ 15,924,831	-	\$ 190,798,746
 December 31, 2011						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	-	\$ 119,933	-	-	-	\$ 119,933
Collectively evaluated for impairment	<u>682,027</u>	<u>519,673</u>	<u>102,363</u>	<u>115,628</u>	<u>125,024</u>	<u>2,426,400</u>
Total ending allowance balance	\$ 682,027	\$ 1,001,618	\$ 102,363	\$ 115,628	\$ 125,024	\$ 2,546,333
 Loans:						
Individually evaluated for impairment	-	\$ 119,933	-	-	-	\$ 119,933
Collectively evaluated for impairment	<u>36,010,693</u>	<u>29,527,521</u>	<u>5,597,475</u>	<u>11,600,604</u>	<u>-</u>	<u>169,604,961</u>
Total ending loans balance	\$ 36,010,693	\$ 86,988,601	\$ 5,597,475	\$ 11,600,604	-	\$ 169,724,894

The Corporation did not have any loans classified as troubled debt restructurings at December 31, 2012. The Corporation did not have any loans classified as past due greater than 30 days, or troubled debt restructurings at December 31, 2011.

**NBT HOLDINGS INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2012 and 2011

**NOTE 3 - LOANS (Continued)**

The following table presents information related to impaired loans by class of loans as of and for the year ended December 31, 2012 and 2011:

	<u>Unpaid Principal Balance</u>	<u>Recorded Investment</u>	<u>Allowance for Loan Losses Allocated</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	<u>Cash Basis Interest Recognized</u>
<u>December 31, 2012</u>						
With an allowance recorded:						
Residential real estate:						
Closed-end	\$ 43,078	\$ 43,078	\$ 43,078	\$ 43,078	\$ 2,187	\$ 2,187
Open-end	446,797	446,797	112,297	447,125	24,599	24,599
Construction and land development:						
Development	<u>56,425</u>	<u>56,425</u>	<u>56,425</u>	<u>56,792</u>	<u>4,772</u>	<u>4,772</u>
Total	<u>546,300</u>	<u>546,300</u>	<u>211,800</u>	<u>546,995</u>	<u>31,558</u>	<u>31,558</u>
<u>December 31, 2011</u>						
With an allowance recorded:						
Residential real estate:						
Open-end	<u>\$ 119,933</u>	<u>\$ 119,933</u>	<u>\$ 119,933</u>	<u>\$ 119,933</u>	<u>\$ 2,983</u>	<u>\$ 2,983</u>
Total	<u>\$ 119,933</u>	<u>\$ 119,933</u>	<u>\$ 119,933</u>	<u>\$ 119,933</u>	<u>\$ 2,983</u>	<u>\$ 2,983</u>

The recorded investment in loans excludes accrued interest receivable and loan origination fees, net due to immateriality. For purposes of this disclosure, the unpaid principal balance is not reduced for partial charge-offs.

**NBT HOLDINGS INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2012 and 2011**

**NOTE 3 - LOANS** (Continued)

Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. Nonaccrual loans consisted of \$43,078 of closed-end residential real estate loans as of December 31, 2012 and \$119,933 of open-end residential real estate loans as of December 31, 2011. There were no loans past due over 90 days and still accruing as of December 31, 2012 or 2011.

The following table presents the aging of the recorded investment in past due loans as of December 31, 2012 by class of loans:

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans Not Past Due	Total
<b>December 31, 2012</b>						
Commercial	\$ -	\$ -	\$ -	\$ -	\$ 34,331,146	\$ 34,331,146
Commercial real estate	-	-	-	-	42,327,688	42,327,688
Residential real estate:						
Closed-end	-	-	43,078	43,078	59,352,320	59,395,398
Open-end	446,797	-	-	446,797	30,125,514	30,572,311
Construction and land development						
Owner occupied	-	-	-	-	4,466,118	4,466,118
Development	-	-	-	-	3,781,254	3,781,254
Consumer	-	-	-	-	15,924,831	15,924,831
<b>Total</b>	<u>\$446,797</u>	<u>\$ -</u>	<u>\$ 43,078</u>	<u>\$ 489,875</u>	<u>\$190,308,871</u>	<u>\$190,798,746</u>

There were no loans greater than 30 days past due as of December 31, 2011.

**Credit Quality Indicators:**

The Corporation categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Corporation periodically analyzes loans individually by classifying the loans as to credit risk. 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 institution'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 institution 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.

**NBT HOLDINGS INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 3 - LOANS** (Continued)

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. As of December 31, 2012 and 2011, based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>
<u>December 31, 2012</u>				
Commercial	\$ 33,490,400	\$ -	\$ 840,746	\$ -
Commercial real estate	42,327,688	-	-	-
Residential real estate:				
Closed-end	57,829,116	612,350	910,854	43,078
Open-end	29,417,109	-	708,405	446,797
Construction and land development:				
Owner occupied	4,466,118	-	-	-
Development	3,569,204	155,625	-	56,425
Consumer	<u>15,911,883</u>	<u>-</u>	<u>12,948</u>	<u>-</u>
 Total	 <u>\$ 187,011,518</u>	 <u>\$ 767,975</u>	 <u>\$ 2,472,953</u>	 <u>\$ 546,300</u>
<u>December 31, 2011</u>				
Commercial	\$ 35,201,409	\$ -	\$ 809,284	\$ -
Commercial real estate	29,527,521	-	-	-
Residential real estate:				
Closed-end	53,233,437	900,666	-	-
Open-end	32,037,563	-	816,935	-
Construction and land development:				
Owner occupied	2,344,330	-	-	-
Development	3,012,209	166,144	74,792	-
Consumer	<u>11,580,500</u>	<u>20,104</u>	<u>-</u>	<u>-</u>
 Total	 <u>\$ 166,936,969</u>	 <u>\$ 1,086,914</u>	 <u>\$ 1,701,011</u>	 <u>\$ -</u>

**NOTE 4 - PREMISES AND EQUIPMENT**

Year-end premises and equipment were as follows:

	<u>2012</u>	<u>2011</u>
Leasehold improvements	\$ 811,542	\$ 234,103
Furniture, fixtures and equipment	592,529	494,845
Computer software	<u>299,323</u>	<u>302,074</u>
	1,703,394	1,031,022
Less: Accumulated depreciation and amortization	<u>846,414</u>	<u>818,905</u>
 Net premises and equipment	 <u>\$ 856,980</u>	 <u>\$ 212,117</u>

Depreciation and amortization expense totaled \$119,859 and \$84,013 for 2012 and 2011, respectively.

The Corporation's main office facility is subject to a six-year lease, terminating June 1, 2018. The lease agreement includes one renewal option of three years. Rent expense for 2012 and 2011 was \$349,711 and \$290,408.

**NBT HOLDINGS INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2012 and 2011**

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**NOTE 4 - PREMISES AND EQUIPMENT (Continued)**

Rent commitments under non-cancelable operating leases were as follows, before considering renewal options that are present.

2013	\$ 380,160
2014	380,160
2015	380,160
2016	380,160
2017	380,160
Thereafter	158,400

The Corporation had operating leases for property and equipment that have non-cancelable lease commitments as follows: \$52,993 for 2013, \$37,499 for 2014 and \$12,975 for 2015. These leases have terms of three years and resulted in lease expense of \$98,009 and \$88,609 for the years ending December 31, 2012 and 2011.

**NOTE 5 - DEPOSITS**

Scheduled maturities of time deposits, included in interest bearing deposits, for the next five years were as follows:

2013	\$ 16,996,150
2014	3,479,513
2015	2,035,443
2016	538,066
2017	1,018,066

Time deposits of \$100,000 or more were \$18,608,383 and \$24,450,548 at December 31, 2012 and 2011, respectively.

**NOTE 6 - FEDERAL HOME LOAN BANK ADVANCES**

At December 31, 2012 and 2011, advances from the Federal Home Loan Bank were as follows:

	<u>2012</u>	<u>2011</u>
For 2012, interest rates ranged from 0.42% to 1.94%, averaging 1.06% with maturities between March 11, 2013 and August 1, 2027.	\$ 17,738,260	
For 2011, rates range from 0.07% to 2.94%, averaging 1.37% with maturities between January 24, 2012 and August 4, 2015.		\$ 17,343,000

The advances are subject to penalties if repaid before scheduled payments are due. The Corporation's outstanding borrowings from the Federal Home Loan Bank are secured by a blanket pledge agreement of 150% of 1-4 family loans, first lien mortgage loans. The Corporation has approximately \$43,131,912 of 1-4 family, first mortgage loans available to pledge under the blanket pledge arrangement dated March 16, 2006. Based on the collateral and the Corporation's holdings of Federal Home Loan Bank Stock, the Corporation is eligible to borrow additional advances of approximately \$25,205,000 as of December 31, 2012.

Payments over the next five years are as follows:

2013	\$ 6,875,681
2014	1,723,988
2015	2,291,470
2016	3,418,845
2017	1,575,094

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**NBT HOLDINGS INC. AND SUBSIDIARY**  
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**NOTE 7 - INCOME TAXES**

Income tax expense was as follows:

	<u>2012</u>	<u>2011</u>
Current expense		
Federal	\$ 1,145,575	\$ 1,206,961
State	<u>191,176</u>	<u>261,892</u>
Total current	1,336,751	1,468,853
Deferred expense (benefit)		
Federal	(77,028)	(280,875)
State	<u>(14,212)</u>	<u>(30,507)</u>
Total deferred	<u>(91,240)</u>	<u>(311,382)</u>
Total	<u>\$ 1,245,511</u>	<u>\$ 1,157,471</u>

Effective tax rates differ from federal statutory rate of 34% applied to income before income taxes due to the following:

	<u>2012</u>	<u>2011</u>
Federal statutory rate times financial statement income	\$ 1,408,633	\$ 1,078,771
Effect of:		
State taxes, net of federal benefit	116,797	152,714
Tax exempt interest income	(170,937)	(59,740)
Bank owned life insurance income	(36,058)	-
Other, net	<u>(72,924)</u>	<u>(14,274)</u>
Total income tax expense	<u>\$ 1,245,511</u>	<u>\$ 1,157,471</u>

Year-end deferred tax assets and liabilities were due to the following:

	<u>2012</u>	<u>2011</u>
Deferred tax assets:		
Allowance for loan losses	\$ 1,038,369	\$ 898,778
Organizational and start-up expenditures	9,876	10,735
Loan origination income	96,411	69,327
Deferred lease incentive	-	1,687
Accrued bonus	161,265	-
Other	<u>10,560</u>	<u>6,847</u>
Total deferred tax assets	1,316,481	987,374
Deferred tax liabilities:		
Prepaid expenses	(143,184)	(103,706)
Stock based compensation expense	(139,073)	(143,697)
Net unrealized gain on available for sale securities	(532,688)	(259,139)
Restricted equity stock dividends	(9,643)	(9,643)
Loan origination expenses	(52,077)	(45,749)
Depreciation	<u>(246,921)</u>	<u>(50,236)</u>
Total deferred tax liabilities	<u>(1,123,586)</u>	<u>(612,170)</u>
Deferred tax asset, net	<u>\$ 192,895</u>	<u>\$ 375,204</u>

The Corporation does not have any uncertain tax positions and does not have any interest and penalties recorded or accrued in the consolidated financial statements for the years ended December 31, 2012 and 2011. The Corporation and its subsidiary are subject to U.S. federal income tax as well as income tax of the state of Tennessee. The Corporation is no longer subject to examination by taxing authorities for years before 2009.

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**NOTE 8 - RELATED PARTY TRANSACTIONS**

Loans to principal officers, directors and their affiliates at December 31, 2012 and 2011 totaled \$3,539,834 and \$3,782,549, respectively.

Deposits from principal officers, directors and their affiliates at December 31, 2012 and 2011 totaled \$1,409,920 and \$2,431,419, respectively.

Wealth management fees earned from assets under management for principal officers, directors and their affiliates at December 31, 2012 and 2011 totaled \$260,348 and \$255,193, respectively.

**NOTE 9 - REGULATORY CAPITAL MATTERS**

Banks are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities and certain off-balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. Management believes as of December 31, 2012, the Bank meets all capital adequacy requirements to which it is subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion and capital restoration plans are required. As of December 31, 2012 and 2011, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

Actual and required capital amounts (shown in thousands) and ratios for the Bank are presented below as of December 31, 2012 and 2011.

	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>2012</u>						
Total Capital to risk weighted assets	\$ 30,471	15.39%	\$ 15,839	8.00%	\$ 19,799	10.00%
Tier 1 (Core) Capital to risk weighted assets	27,911	14.14%	7,920	4.00%	11,879	6.00%
Tier 1 (Core) Capital to average assets	27,911	9.50%	11,784	4.00%	14,729	5.00%
<u>2011</u>						
Total Capital to risk weighted assets	\$ 27,002	15.88%	\$ 13,601	8.00%	\$ 17,001	10.00%
Tier 1 (Core) Capital to risk weighted assets	24,872	14.63%	6,800	4.00%	10,201	6.00%
Tier 1 (Core) Capital to average assets	24,872	10.02%	9,926	4.00%	12,408	5.00%

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**NOTE 9 - REGULATORY CAPITAL MATTERS (Continued)**

**Dividend Restrictions** - The Corporation's principal source of funds for dividend payments is dividends received from the Bank. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. Under these regulations, the amount of dividends that may be paid in any calendar year is limited to the current year's net profits, combined with the retained net profits of the preceding two years, subject to the capital requirements described above. During 2013, the Bank could, without prior approval, declare dividends of approximately \$4,932,000 plus any 2013 net profits retained to date of declaration.

**NOTE 10 - 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. In addition, these agreements usually have expiration dates, and the 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 the exercise of the commitment. The majority of the Corporation's commitments to extend credit have maturities of less than one year and reflect the prevailing market interest rates at the time of the commitment.

The contractual amount of financial instruments with off-balance sheet risk was as follows at December 31:

	<u>2012</u>	<u>2011</u>
Letters of Credit	\$ 1,895,869	\$ 1,217,820
Unused Lines of Credit	43,435,382	46,896,627

**NOTE 11 - STOCK BASED COMPENSATION PLAN**

Total stock based compensation expense in 2012 and 2011 was \$214,759 and \$168,606, respectively. Related to the 2012 and 2011 restricted stock grants, some employees made an election, in accordance with Section 83(b) of the Internal Revenue Code, to have the fair value of the awards taxable immediately. In connection with the election, the Corporation allowed the employees to forfeit shares to cover the related personal tax obligation. During 2012 employees forfeited 4,445 shares with a fair value of \$55,563. During 2011, employees forfeited 6,494 shares with a fair value of \$66,434. These amounts were recorded in salaries and employee benefits on the Corporation's consolidated statements of income in 2012 and 2011.

The Corporation's 2008 Equity Incentive Plan provides for the grant of stock options, restricted stock and other equity based incentives up to 600,000 shares. As of December 31, 2012, the Corporation had issued grants totaling 517,890 shares under the 2008 Equity Incentive Plan and its predecessor, the 2004 Employee Share Option Plan.

**NBT HOLDINGS INC. AND SUBSIDIARY**  
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**NOTE 11 - STOCK BASED COMPENSATION PLAN (Continued)**

Stock Option Grants

Option awards are granted with an exercise price equal to the market price of the Corporation's common stock at the date of grant. Option awards have vesting periods of one to three years and have 10-year contractual terms. The Corporation uses newly-issued shares to satisfy share option exercises.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected volatilities are based on historical trading of the shares of NBT Holdings Inc.'s common stock for 2012 and 2011. The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding taking into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant.

The Corporation issued non-qualified options for the purchase of 3,150 shares in 2012 and 3,500 shares in 2011 of common stock to outside directors. The fair value of options granted in 2012 and 2011 was determined using the following assumptions as of grant date:

	<u>2012</u>	<u>2011</u>
Risk-free interest rate	1.65%	2.20%
Expected term	10 years	10 years
Expected stock price volatility	17.22%	15.60%
Dividend yield	0.00%	0.00%

A summary of the stock option activity for 2012 follows:

	<u>Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at beginning of year	261,650	\$ 10.28		
Granted	3,150	11.55		
Forfeited	(18,250)	10.47		
Exercised	<u>(13,200)</u>	10.82		
Outstanding at end of year	<u>233,350</u>	<u>\$ 10.27</u>	2.7	\$ 466,700
Vested or expected to vest	233,350	\$ 10.25	2.7	466,700
Exercisable at end of year	<u>230,200</u>	<u>\$ 10.23</u>	2.6	465,004

During 2012, 11,700 shares were exercised in exchange for repurchase of shares in the amount of \$15,640.

Information related to stock options during each year follows:

	<u>2012</u>	<u>2011</u>
Intrinsic value of options exercised	\$ 17,005	\$ 8,890
Cash received from option exercises	\$ 110	\$ -
Tax benefit realized from option exercises	\$ -	\$ -
Weighted average fair value of options granted	\$ 1.99	\$ 3.49

There was a total of \$28,440 unrecognized compensation cost related to non-vested stock options granted under the Plan as of December 31, 2012. The cost is expected to be recognized over a weighted-average period of 0.6 years.

**NBT HOLDINGS INC. AND SUBSIDIARY**  
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**NOTE 11 - STOCK BASED COMPENSATION PLAN** (Continued)

Restricted Stock Grants

In 2012 and 2011, the Corporation issued 23,540 and 31,275 restricted shares of common stock. Compensation expense is recognized over the vesting period of the awards based on the value of the stock at issue date. The fair value of the stock was determined by current stock trade activity. These shares vest in 20% increments through 2016.

A summary of the changes in the Corporation's non-vested shares for the year follows:

<u>Non-vested shares</u>	<u>Shares</u>	<u>Weighted-Average Grant-Date Fair Value</u>
Non-vested at January 1, 2012	54,661	\$ 10.21
Granted	23,540	12.50
Vested	(15,896)	10.27
Forfeited	<u>(4,445)</u>	<u>12.50</u>
Non-vested at December 31, 2012	<u>57,860</u>	<u>\$ 10.83</u>

As of December 31, 2012, there was \$476,746 of total unrecognized compensation cost related to non-vested restricted shares granted under the Plan. The cost is expected to be recognized over a weighted-average period of 1.6 years.

**NOTE 12 - STOCK WARRANTS**

Warrants for the purchase of 100,000 shares of common stock at \$10 per share were granted to the organizers of the Corporation, four of which were also executive officers or directors as of December 31, 2012. No warrants were exercised in 2012 or 2011. As of December 31, 2012, 100,000 warrants were outstanding and exercisable, with weighted average exercise price of \$10.00 and weighted average remaining contractual term of 1.7 years. The outstanding and exercisable warrants had intrinsic value of \$225,000 as of December 31, 2012.

**NOTE 13 - FAIR VALUES OF FINANCIAL INSTRUMENTS**

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

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.

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**NOTE 13 - FAIR VALUES OF FINANCIAL INSTRUMENTS** (Continued)

The Corporation used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Investment Securities: The fair values for investment securities are determined by quoted market prices, if available "Level 1". For securities where quoted prices are not available, fair values are calculated using a matrix pricing model, which is based on market prices of similar securities "Level 2".

Impaired Loans: At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for loan losses. For collateral dependent loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a "Level 3" classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a "Level 3" fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Appraisals for collateral-dependent impaired loans are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, the Company reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

	Fair Value Measurements at December 31, 2012 Using:		
	Carrying Value	Quoted Prices In Active Markets for Identical Assets "Level 1"	Significant Other Observable Inputs "Level 2"
<b>Financial assets:</b>			
Investment securities available for sale			
U.S. government sponsored entities and agencies	\$ 4,933,936	\$ -	\$ 4,933,936
Corporate bonds	4,983,694	-	4,983,694
State and political subdivisions	19,351,197	-	19,351,197
Collateralized mortgage obligations	6,242,564	-	6,242,564
Mortgage backed securities - residential	16,865,055	-	16,865,055
Mortgage backed securities – commercial	<u>21,370,423</u>	<u>                    </u>	<u>21,370,423</u>
 Total investment securities available for sale	 <u>\$ 73,746,869</u>	 <u>\$ -</u>	 <u>\$ 73,746,869</u>

**NBT HOLDINGS INC. AND SUBSIDIARY**  
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**NOTE 13 - FAIR VALUES OF FINANCIAL INSTRUMENTS** (Continued)

	Fair Value Measurements at December 31, 2011 Using:		
	Carrying Value	Quoted Prices In Active Markets for Identical Assets "Level 1"	Significant Other Observable Inputs "Level 2"
Financial assets:			
Investment securities available for sale			
U.S. government sponsored entities and agencies	\$ 4,210,210	\$ -	\$ 4,210,210
Corporate bonds	5,294,759	-	5,294,759
State and political subdivisions	10,952,381	-	10,952,381
Collateralized mortgage obligations	1,600,426	-	1,600,426
Mortgage backed securities - residential	10,797,098	-	10,797,098
Mortgage backed securities - commercial	7,004,208	-	7,004,208
 Total investment securities available for sale	 \$ 39,859,082	 \$ -	 \$ 39,859,082

There were no transfers between Level 1 and Level 2 during 2012 or 2011.

Assets measured at fair value on a non-recurring basis are summarized below:

	Fair Value Measurements at December 31, 2012 Using:			
	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Impaired loans:				
Residential real estate:				
Open-end	\$ 334,500	\$ -	\$ -	\$ 334,500

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of \$546,300, with a valuation allowance of \$211,800 at December 31, 2012, resulting in an additional provision for loan losses of \$91,867 for the year ended December 31, 2012. At December 31, 2011, impaired loans had a principal balance of \$119,933, with a valuation allowance of \$119,933, resulting in an additional provision for loan losses of \$119,933 for the year ended December 31, 2011.

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**NOTE 13 - FAIR VALUES OF FINANCIAL INSTRUMENTS** (Continued)

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, 2012:

	<u>Fair value</u>	<u>Valuation Techniques</u>	<u>Unobservable Inputs</u>	<u>Range (Weighted Average)</u>
Impaired loans – Residential real Estate – open end	\$ 334,500	Sales comparison approach	Adjustment for differences between the comparable sales	-2.0% to 8.3% (1.5%)

The carrying amounts and estimated fair values of financial instruments, at December 31, 2012 and December 31, 2011 are as follows:

	<u>Fair Value Measurements at December 31, 2012 Using:</u>				
	<u>Carrying Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>Financial assets</b>					
Cash and cash equivalents	\$ 18,149,874	\$ 18,149,874	\$ -	\$ -	\$ 18,149,874
Time deposits in other financial institutions	10,201,000	-	10,266,201	-	10,266,201
Securities available-for-sale	73,746,869	-	73,746,869	-	73,746,869
Restricted equity securities	1,872,500	N/A	N/A	N/A	N/A
Loans, net	187,772,067	-	-	190,918,801	190,918,801
Accrued interest receivable	859,694	-	365,341	494,353	859,695
<b>Financial liabilities</b>					
Deposits	\$ 252,108,656	\$ -	\$ 254,839,026	\$ -	\$ 254,839,026
Federal Home Loan Bank advances	17,738,260	-	17,929,600	-	17,929,600
Accrued interest payable	17,528	-	17,528	-	17,528

	<u>2011</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>
<b>Financial assets</b>		
Cash and cash equivalents	\$ 18,679,737	\$ 18,679,737
Time deposits in other financial institutions	12,368,000	12,436,725
Securities available for sale	39,859,082	39,859,082
Loans, net	167,116,983	168,791,565
Restricted equity securities	1,866,350	N/A
Accrued interest receivable	718,984	718,984
<b>Financial liabilities</b>		
Deposits	\$ 197,525,826	\$ 194,451,024
Federal Home Loan Bank advances	17,343,000	17,575,000
Accrued interest payable	25,216	25,216



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**NOTE 13 - FAIR VALUES OF FINANCIAL INSTRUMENTS** (Continued)

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

The carrying amount of cash and cash equivalents approximates fair values and are classified as Level 1. Time deposits in other financial institutions have infrequent repricing or repricing limits and their fair value is based on discounted cash flows using current market rates applied to the estimated life and are classified as Level 2. It is not practical to determine the fair value of restricted equity securities due to the restrictions placed on its transferability. 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 flows, 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. The fair values disclosed for demand deposits are by definition, equal to the amount payable on demand at the reporting date resulting in a Level 2 classification. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flows 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. The fair values of the Company's Federal Home Loan Bank advances are estimated using discounted cash flows based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification. The carrying amounts of accrued interest approximate fair value resulting in Level 2 or 3 classifications.

**NOTE 14 - OTHER BENEFIT PLANS**

In 2005, the Corporation adopted a 401(k) benefit plan that covers all employees who meet certain eligibility requirements and choose to participate in the plan. The plan allows employee contributions up to 15% of their compensation, which are matched 100% for the first 3% of compensation contributed. 87.5% is matched on the first 4% of compensation contributed, and 80% is matched on the first 5% of compensation contributed beginning on the first day of the calendar quarter following the employee's one year anniversary. The 401(k) benefit plan expense for 2012 and 2011 was \$152,402 and \$124,188 respectively.

**NOTE 15 – EARNINGS PER SHARE**

Basic earnings per share available to common shareholders is computed by dividing net income adjusted for income allocated to participating securities by the weighted average number of common shares outstanding during the period. All outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends are considered participating securities for this calculation. Diluted earnings per share available to common shareholders reflects the potential dilution that could occur if stock options to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. The factors used in the earnings per share computation follows:

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**NOTE 15 – EARNINGS PER SHARE** (Continued)

	<u>2012</u>	<u>2011</u>
Basic		
Net income	\$ 2,897,526	\$ 2,015,386
Less: Undistributed income allocated to participating securities	<u>(74,665)</u>	<u>(49,644)</u>
Net earnings allocated to common stock	<u>\$ 2,822,861</u>	<u>\$ 1,965,742</u>
Weighted common shares outstanding including participating securities	2,245,368	2,219,066
Less: Participating securities	<u>(57,860)</u>	<u>(54,661)</u>
Weighted average shares	<u>2,187,508</u>	<u>2,164,405</u>
Basic earnings per share	<u>\$ 1.29</u>	<u>\$ 0.91</u>
Diluted earnings allocated to common stock	<u>\$ 2,822,861</u>	<u>\$ 1,965,742</u>
Weighted average shares	2,187,508	2,164,405
Add: Diluted effects of assumed exercises of stock options and warrants	<u>47,831</u>	<u>34,698</u>
Average shares and dilutive potential common shares	<u>2,235,339</u>	<u>2,199,103</u>
Dilutive earnings per share	<u>\$ 1.26</u>	<u>\$ 0.89</u>

At year end 2012 and 2011, there were no stock options and no warrants that were considered antidilutive. Therefore, none were excluded from the diluted earnings per common share calculation.



