

« PANDORA BANCSHARES, INC. »

ANNUAL REPORT

2013

« »



First National Bank

You. First. Always.

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PANDORA BANCSHARES, INC.

102 East Main Street
P.O. Box 329
Pandora, Ohio 45877-0329
(419) 384-3221

January 31, 2014

Dear Shareholders and Friends:

Pandora Bancshares, Inc. is pleased to announce that 2013 results have exceeded our expectations. Our leadership team is excited to inform you that net income increased 13.5%, assets increased 4.1% and Pandora Bancshares stock market price increased 6.2% to \$76 per share. We are also extremely pleased with the strong credit quality in our loan department as evidenced by a loan delinquency of 1.32%. This compares to the peer delinquency of 2.49% as of December 31, 2013.

In 2013, our national economy showed signs of improvement. Positive indicators nationally include the unemployment rate falling below 7% and housing starts increasing by 8%. This healthy trend in the economy has allowed rates to tick up slightly. Although this increase in rates will have a positive effect on our net interest margin, the negative side to the increase is a significant reduction in the number of customers seeking home mortgage refinances. This, in turn, reduces the bank's ability to generate non-interest income through loan fees.

Closer to home, we are very excited about low unemployment with Hancock, Putnam and Allen counties having unemployment rates of 5.2%, 5.7% and 7.0% respectively. Hancock County's unemployment is the sixth best rate reported by a county in Ohio. Further, we are very encouraged by four consecutive years of strong income in the local agricultural industry. Gross income in 2014 may be softer due to lower commodity prices; however, the low amount of debt on our agriculture customers' financial statements has them in a very strong position. Finally, the Bank celebrated the one-year anniversary of the Findlay West office in 2013. This news is even more exciting given that this office has exceeded expectations since opening.

In 2014, First National Bank will continue its mission of being a premier community bank that knows our customers by name, personally invests in our local communities and provides financial solutions to our neighbors. We will continue with the strategic vision to grow our organization in a manner that will be of benefit to our community. We are thrilled about our newest community partnership with the upcoming opening of our office at 855 North Locust Street, Ottawa, in May of this year. The people of Ottawa have expressed their sincere desire to have First National Bank be a part of their community and we look forward to making this a reality.

We will continue to keep you updated on the completion of the Ottawa office, as well as any other items of interest. Our preference is to communicate by email, as it allows for quicker delivery and better cost efficiency. If you have not provided this information yet, please do so by contacting Liz Gross at 419-384-9104 or by email at egross@e-fnb.com.

The Directors, Management and Staff are very excited about the continued positive direction of First National Bank and the strategy to increase shareholder value. We thank you for your investment, your business and your future business. We look forward to seeing you at the Annual Shareholder Meeting on April 26, 2014 at the Findlay Country Club, Findlay, Ohio.

Respectfully,



Todd A. Mason
President & CEO
The First National Bank



Charles Niswander
Chairman
Pandora Bancshares, Inc.



Donald R. Dreisbach
Chairman
The First National Bank

PANDORA BANCSHARES, INC.
FIVE YEAR SUMMARY OF SELECTED FINANCIAL DATA

	Years ended December 31				
	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
	(Dollars in thousands, except per share data)				
Statements of operations:					
Total interest income	\$ 5,268	\$ 5,348	\$ 5,454	\$ 5,770	\$ 6,111
Total interest expense	<u>689</u>	<u>917</u>	<u>1,076</u>	<u>1,304</u>	<u>1,861</u>
Net interest income	4,579	4,431	4,378	4,466	4,250
Provision for loan losses	<u>120</u>	<u>350</u>	<u>225</u>	<u>465</u>	<u>140</u>
Net interest income after provision for loan losses	4,459	4,081	4,153	4,001	4,110
Total non-interest income	1,153	1,440	1,059	1,123	946
Total non-interest expenses	<u>4,942</u>	<u>4,940</u>	<u>4,183</u>	<u>4,027</u>	<u>3,935</u>
Income before federal income taxes	670	581	1,029	1,097	1,121
Federal income taxes	<u>144</u>	<u>118</u>	<u>266</u>	<u>287</u>	<u>315</u>
Net income	<u>\$ 526</u>	<u>\$ 463</u>	<u>\$ 763</u>	<u>\$ 810</u>	<u>\$ 806</u>
Per share of common stock:					
Net income	\$ 4.31	\$ 3.81	\$ 6.26	\$ 6.62	\$ 6.47
Dividends	1.90	1.85	1.80	1.80	1.60
Book value	95.92	99.01	97.22	90.48	87.16
Year-end balances					
Loans, net (A)	\$ 91,473	\$ 80,999	\$ 74,137	\$ 73,962	\$ 76,863
Securities and restricted stock	36,436	41,892	40,794	38,468	28,897
Total assets	146,391	140,572	132,032	128,446	122,770
Deposits	127,593	122,203	111,199	110,111	104,425
Stockholders' equity	11,762	12,028	11,829	11,017	10,796
Average balances:					
Loans, net (A)	\$ 86,551	\$ 77,341	\$ 73,643	\$ 74,448	\$ 74,636
Securities	37,969	42,812	38,942	31,046	27,204
Total assets	138,766	134,833	127,654	120,012	113,924
Deposits	118,600	113,983	109,085	102,077	95,969
Stockholders' equity	11,874	11,936	11,644	11,009	10,529
Selected ratios:					
Net yield on average interest-earning assets	3.61%	3.59%	3.72%	4.03%	4.05%
Return on average assets	0.38%	0.34%	0.60%	0.68%	0.71%
Return on average stockholders' equity	4.44%	3.86%	6.55%	7.36%	7.66%
Allowance for loan losses as a percentage of year-end loans	1.65%	1.69%	1.65%	1.60%	1.58%
Year-end stockholders' equity as a percentage of year-end assets	8.03%	8.56%	8.96%	8.58%	8.79%

(A) Includes loans held for sale



CliftonLarsonAllen

INDEPENDENT AUDITORS' REPORT

Board of Directors
Pandora Bancshares, Inc.
Pandora, Ohio

We have audited the accompanying consolidated financial statements of Pandora Bancshares, Inc. and its subsidiary, which comprise the consolidated balance sheets, as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' 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 financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the 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 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 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 Pandora Bancshares, Inc. and its subsidiary as of December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

CliftonLarsonAllen LLP

Toledo, Ohio
February 19, 2014



PANDORA BANCSHARES, INC.
CONSOLIDATED BALANCE SHEETS
December 31, 2013 and 2012

ASSETS	<u>2013</u>	<u>2012</u>
Cash and due from banks	\$ 6,151,227	\$ 4,142,198
Federal funds sold	<u>3,666,000</u>	<u>4,798,000</u>
Total cash and cash equivalents	<u>9,817,227</u>	<u>8,940,198</u>
Securities, available-for-sale	35,457,384	40,913,352
Restricted stock	979,050	979,050
Loans held for sale	236,400	389,103
Loans, net of allowance for loan losses of \$1,534,621 in 2013 and \$1,388,293 in 2012	91,236,880	80,609,525
Premises and equipment, net	3,979,849	4,128,566
Other real estate owned	-	66,947
Accrued interest receivable	633,179	640,792
Cash surrender value of life insurance	3,123,798	3,052,122
Other assets	<u>927,397</u>	<u>852,203</u>
TOTAL ASSETS	<u>\$ 146,391,164</u>	<u>\$ 140,571,858</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Noninterest-bearing	\$ 26,208,861	\$ 22,921,111
Interest-bearing	<u>101,383,751</u>	<u>99,282,312</u>
Total deposits	127,592,612	122,203,423
Federal Home Loan Bank borrowings	5,523,170	5,041,633
Other liabilities	<u>1,513,777</u>	<u>1,299,264</u>
Total liabilities	<u>134,629,559</u>	<u>128,544,320</u>
STOCKHOLDERS' EQUITY		
Common stock, \$5.00 par value. Authorized 500,000 shares; issued 160,821 shares in 2013 and 159,388 shares in 2012	804,107	796,942
Additional paid-in capital	2,636,447	2,559,415
Retained earnings	10,776,150	10,483,114
Accumulated other comprehensive income (loss)	(73,294)	545,403
Treasury stock, at cost – 38,207 shares in 2013 and 37,911 shares in 2012	<u>(2,381,805)</u>	<u>(2,357,336)</u>
Total stockholders' equity	<u>11,761,605</u>	<u>12,027,538</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$ 146,391,164</u>	<u>\$ 140,571,858</u>

This accompanying notes are an integral part of the consolidated financial statements.

PANDORA BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
Years Ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
INTEREST INCOME		
Loans – including fees	\$ 4,571,472	\$ 4,569,483
Securities:		
Taxable	462,555	579,486
Tax-exempt	187,774	151,510
Dividends on restricted stock	41,195	41,973
Other	<u>4,625</u>	<u>5,555</u>
Total interest income	<u>5,267,621</u>	<u>5,348,007</u>
INTEREST EXPENSE		
Deposits	559,889	718,780
Other borrowings	<u>128,888</u>	<u>198,472</u>
Total interest expense	<u>688,777</u>	<u>917,252</u>
Net interest income	4,578,844	4,430,755
PROVISION FOR LOAN LOSSES	<u>120,000</u>	<u>350,000</u>
Net interest income after provision for loan losses	<u>4,458,844</u>	<u>4,080,755</u>
NON-INTEREST INCOME		
Service charges:		
Deposit accounts	254,939	259,825
Other	24,518	28,871
Gain on sale of securities	68,825	166,344
Gain on sale of loans	366,565	699,826
Increase in cash surrender value of life insurance	71,676	91,547
Other, net	<u>366,745</u>	<u>193,813</u>
Total non-interest income	<u>1,153,268</u>	<u>1,440,226</u>
NON-INTEREST EXPENSES		
Salaries, wages and employee benefits	2,458,918	2,444,495
Occupancy and equipment	424,702	410,614
Data processing	592,627	580,768
Federal deposit insurance assessment	105,735	93,735
Professional and director fees	305,466	257,986
Advertising and marketing	183,104	188,077
Franchise tax	145,360	145,091
Other operating expenses	<u>725,863</u>	<u>818,722</u>
Total non-interest expenses	<u>4,941,775</u>	<u>4,939,488</u>
Income before income taxes	670,337	581,493
PROVISION FOR INCOME TAXES	<u>143,700</u>	<u>118,100</u>
NET INCOME	<u>\$ 526,637</u>	<u>\$ 463,393</u>
Net income per share:		
Basic	<u>\$ 4.31</u>	<u>\$ 3.81</u>
Diluted	<u>\$ 4.28</u>	<u>\$ 3.79</u>

This accompanying notes are an integral part of the consolidated financial statements.

PANDORA BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
NET INCOME	<u>\$ 526,637</u>	<u>\$ 463,393</u>
OTHER COMPREHENSIVE INCOME (LOSS)		
Change in unrealized gains (losses) on available-for-sale securities	(868,593)	133,704
Reclassification adjustments for securities gains realized in income	<u>(68,825)</u>	<u>(166,344)</u>
Net unrealized losses	(937,418)	(32,640)
Income tax effect	<u>(318,721)</u>	<u>(11,098)</u>
Other comprehensive loss	<u>(618,697)</u>	<u>(21,542)</u>
TOTAL COMPREHENSIVE INCOME (LOSS)	<u>\$ (92,060)</u>	<u>\$ 441,851</u>

This accompanying notes are an integral part of the consolidated financial statements.

PANDORA BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years Ended December 31, 2013 and 2012

	Common stock	Additional paid-in capital	Retained earnings	Accumulated other compre- hensive income	Treasury stock	Total
BALANCE AT DECEMBER 31, 2011	\$ 796,942	\$ 2,559,415	\$ 10,248,267	\$ 566,945	\$(2,342,315)	\$ 11,829,254
Net income	-	-	463,393	-	-	463,393
Other comprehensive loss	-	-	-	(21,542)	-	(21,542)
Purchase of 1,348 treasury shares	-	-	-	-	(87,918)	(87,918)
Grant of 310 shares to officers	-	-	-	-	18,600	18,600
Sale of 845 treasury shares	-	-	(3,605)	-	54,297	50,692
Dividends declared – \$1.85 per share	-	-	(224,941)	-	-	(224,941)
BALANCE AT DECEMBER 31, 2012	796,942	2,559,415	10,483,114	545,403	(2,357,336)	12,027,538
Net income	-	-	526,637	-	-	526,637
Other comprehensive loss	-	-	-	(618,697)	-	(618,697)
Purchase of 1,918 treasury shares	-	-	-	-	(139,854)	(139,854)
Grant of 157 shares to officers	-	-	-	-	10,866	10,866
Sale of 1,465 treasury shares	-	-	(635)	-	104,519	103,884
Common shares issued 1,433	7,165	77,032	-	-	-	84,197
Dividends declared – \$1.90 per share	-	-	(232,966)	-	-	(232,966)
BALANCE AT DECEMBER 31, 2013	<u>\$ 804,107</u>	<u>\$ 2,636,447</u>	<u>\$ 10,776,150</u>	<u>\$ (73,294)</u>	<u>\$(2,381,805)</u>	<u>\$ 11,761,605</u>

This accompanying notes are an integral part of the consolidated financial statements.

PANDORA BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 526,637	\$ 463,393
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	383,719	425,529
Provision for loan losses	120,000	350,000
Securities premium amortization, net of discount accretion	268,437	328,246
Deferred federal income taxes	(76,379)	(6,902)
Grant of stock to officers	10,866	18,600
Increase in cash surrender value of life insurance	(71,676)	(91,547)
Gain on sale of securities	(68,825)	(166,344)
Gain on sale of loans	(366,565)	(699,826)
Loss (gain) on sale of other real estate owned	(42,725)	30,296
Loss on disposal of equipment	12,375	-
Effects of changes in operating assets and liabilities:		
Loans held for sale	152,703	(302,103)
Accrued interest receivable	7,612	33,601
Other assets	225,649	105,076
Other liabilities	<u>278,451</u>	<u>(129,032)</u>
Net cash provided by operating activities	<u>1,360,279</u>	<u>358,987</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Available-for-sale securities:		
Sales	3,511,250	8,107,006
Maturities, prepayments and calls	10,055,499	6,396,107
Purchases	(9,247,811)	(15,795,701)
Proceeds from sale of life insurance policy	-	10,150
Net increase in loans	(10,530,650)	(6,634,649)
Proceeds from sale of equipment	5,253	-
Proceeds from sale of other real estate owned	109,672	50,442
Premiums paid on life insurance policies	-	(12,796)
Additions to premises and equipment	<u>(80,513)</u>	<u>(1,012,484)</u>
Net cash used in investing activities	<u>(6,177,300)</u>	<u>(8,891,925)</u>

This accompanying notes are an integral part of the consolidated financial statements.

PANDORA BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	\$ 5,389,192	\$ 11,004,681
Federal Home Loan Bank borrowings	12,600,500	6,200,000
Principal payments on Federal Home Loan Bank borrowings	(12,118,963)	(8,722,395)
Proceeds from issuance of common stock	84,197	-
Proceeds from sale of treasury shares	103,884	50,692
Purchase of treasury shares	(139,854)	(87,918)
Payment of dividends	<u>(224,906)</u>	<u>(218,972)</u>
Net cash provided by financing activities	<u>5,694,050</u>	<u>8,226,088</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	877,029	(306,850)
CASH AND CASH EQUIVALENTS		
At beginning of year	<u>8,940,198</u>	<u>9,247,048</u>
At end of year	<u>\$ 9,817,227</u>	<u>\$ 8,940,198</u>
SUPPLEMENTAL CASH FLOW DISCLOSURES		
Cash paid for:		
Interest	<u>\$ 694,032</u>	<u>\$ 931,094</u>
Income taxes	<u>\$ 130,000</u>	<u>\$ 150,000</u>
Non-cash operating activity:		
Change in deferred income taxes on net unrealized gains (losses) on available-for-sale securities	<u>\$ (318,721)</u>	<u>\$ (11,098)</u>
Non-cash investing activity:		
Change in net unrealized gains (losses) on available-for-sale securities	<u>\$ (937,418)</u>	<u>\$ (32,640)</u>
Non-cash operating and investing activity:		
Transfer of loans to other real estate owned	<u>\$ -</u>	<u>\$ 118,452</u>

The accompanying notes are an integral part of the consolidated financial statements.

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Pandora Bancshares, Inc. (the "Corporation") was incorporated in 1986 in the state of Ohio as a single-bank holding company for First National Bank of Pandora (the "Bank"). The Corporation, through its wholly-owned subsidiary, the Bank, operates in one industry segment, the commercial banking industry. The Bank, organized in 1919 as a national chartered bank, is headquartered in Pandora, Ohio, with branch offices in Bluffton and Findlay, Ohio.

The primary source of revenue of the Bank is providing loans to customers primarily located in Northwestern and West Central Ohio. Such customers are predominately small and middle-market businesses and individuals.

Significant accounting policies followed by the Corporation are presented below.

Use of Estimates in Preparing Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during each reporting period. Actual results could differ from those estimates. The most significant estimates susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of servicing assets.

Principles of Consolidation

The consolidated financial statements include the accounts of the Corporation and the Bank. All significant intercompany balances and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold which mature overnight or within four days, and bank certificates of deposit with original maturities of 90 days or less.

Restrictions on Cash

The Bank was required to maintain \$736,000 and \$588,000, respectively, of cash on hand or on deposit with the Federal Reserve Bank to meet regulatory reserve and clearing requirements at December 31, 2013 and 2012.

Securities and Restricted Stock

Securities are classified as available-for-sale and recorded at fair value, with unrealized gains and losses, net of applicable income taxes, excluded from income and reported as accumulated other comprehensive income (loss).

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Securities and Restricted Stock, Continued

The cost of available-for-sale debt securities is adjusted for amortization of premiums to call date and accretion of discounts to date of maturity. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in fair value of securities below their cost that are deemed to be other than temporary are reflected in income as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the intent to sell the securities and the more likely than not requirement for the Corporation will be required to sell the securities prior to recovery, (2) the length of time and the extent to which the fair value has been less than cost, and (3) the financial condition and near-term proposals of the issuer. Gains and losses on the sale of securities are recorded on the trade date, using the specific identification method, and are included in non-interest income.

Investments in restricted stock, principally consisting of Federal Home Loan Bank of Cincinnati and Federal Reserve Bank stock, are classified as restricted securities, carried at cost, and evaluated for impairment.

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are stated at their outstanding principal amount adjusted for charge-offs and the allowance for loan losses. Interest is accrued as earned based upon the daily outstanding principal balance. Loan origination fees and certain direct obligation costs are capitalized and recognized as an adjustment of the yield of the related loan.

The accrual of interest is generally discontinued at the time a loan is 90 days past due unless the credit is well-secured and in process of collection. Past due status is based on contractual terms of the loan. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans placed on nonaccrual or charged-off is reversed against interest income. Interest on these 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.

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. Due to potential changes in conditions, it is at least reasonably possible that changes in estimates will occur in the near term and that such changes could be material to the amounts reported in the Corporation's consolidated financial statements.

The allowance consists of specific, general and unallocated components. The specific component relates to impaired loans when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers classified loans (substandard or special mention) without specific reserves, as well as non-classified loans, and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in 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. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Loan Losses, Continued

Under certain circumstances, the Bank may provide borrowers relief through loan restructurings. A restructuring of debt constitutes a troubled debt restructuring (TDR) if the Bank, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. Concessions may include reduction of interest rates, extension of maturity dates, forgiveness of principal or interest due, or acceptance of other assets in full or partial satisfaction of the debt. TDR loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment, as previously described. TDR loans that have performed as agreed under the restructured terms for a period of 12 months or longer may cease to be reported as a TDR loan. However, the loan continues to be individually evaluated for impairment.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment disclosures.

Other Real Estate Owned

Assets acquired through, or in lieu of, loan foreclosure are initially recorded at fair value less estimated costs to sell and any loan balance in excess of such value is charged to the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and fair value adjustments are included in other operating expenses.

Servicing

Mortgage servicing rights are recognized as an asset when acquired through sale of loans. Capitalized servicing rights are reported in other assets and amortized to expense in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. Mortgage servicing rights are evaluated for impairment based upon the estimated fair value of the rights as compared to amortized cost. Fair value is determined based upon estimated discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance to the extent that fair value is less than the capitalized amount.

Servicing fee income is recorded for fees earned for servicing loans and is included in other operating income, net of amortization of mortgage servicing rights.

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Premises and Equipment

Premises and equipment is stated at cost, less accumulated depreciation. Upon the sale or disposition of the assets, the difference between the depreciated cost and proceeds is charged or credited to income. Depreciation is determined based on the estimated useful lives of the individual assets (typically 20 to 40 years for buildings and 3 to 10 years for equipment) and is computed using the straight-line method.

Premises and equipment 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.

Off-Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Bank has entered into commitments to extend credit, including commitments under credit card arrangements, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded when they are funded.

Supplemental Retirement and Postretirement Benefits

Annual provisions are made for the estimated liability for accumulated supplemental retirement benefits under agreements with certain officers, directors, and former employees of the Bank. These provisions are determined based on the terms of the agreements, as well as certain assumptions including estimated service periods and discount rates.

Advertising and Marketing Costs

Advertising and marketing costs are expensed as incurred.

Federal Income Taxes

The Corporation and Bank are currently subject only to federal income taxes. Any penalties resulting from the filing of its income tax returns are included in the provision for income taxes and any interest is included in interest expense.

Deferred income taxes are provided on temporary differences between financial statement and income tax reporting. Temporary differences are differences between the amounts of assets and liabilities reported for financial statement purposes and their tax bases. Deferred tax assets are recognized for temporary differences that will be deductible in future years' tax returns and for operating loss and tax credit carryforwards. Deferred tax assets are recognized only if it is more likely than not that a tax position will be realized or sustained upon examination by the relevant taxing authority. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. Deferred tax assets are reduced by a valuation allowance if it is deemed more likely than not that some or all of the deferred tax assets will not be realized. Deferred tax liabilities are recognized for temporary differences that will be taxable in future years' tax returns.

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

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 surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) 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 (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

The transfer of a participating interest in a financial asset must have all of the following characteristics: (1) from the date of transfer, it must represent a proportionate ownership interest in the financial asset, (2) from the date of transfer, all cash flows received, except cash flows allocated as compensation for servicing or other services performed, must be divided proportionately among participating interest holders in the amount equal to their share ownership, (3) the rights of each participating interest holder must have the same priority, and (4) no party has the right to pledge or change the entire financial asset unless all participating interest holders agree to do so.

Comprehensive Income

Recognized revenue, expenses, gains and losses are included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the consolidated balance sheet, such items, along with net income, are components of comprehensive income.

Rate Lock Commitments

Loan commitments related to the origination or acquisition of mortgage loans that will be held for sale are accounted for as derivative instruments. The Bank enters into commitments to originate loans whereby the interest rate on the loan is determined prior to funding (rate lock commitments). Rate lock commitments on mortgage loans that are intended to be sold are considered to be derivatives. Accordingly, such commitments, along with any related fees received from potential borrowers, are to be recorded at fair value as derivative assets or liabilities, with changes in fair value recorded in the net gain or loss on sale of mortgage loans. Fair value is based on fees currently charged to enter into similar agreements, and for fixed-rate commitments also considers the difference between current levels of interest rates and the committed rates. At December 31, 2013 and 2012, derivative assets and liabilities relating to rate lock commitments were not material to the consolidated financial statements.

Per Share Data

Basic net income per common share represents net income divided by weighted average number of common shares outstanding during the year. Diluted net income per common share includes any dilutive effect of additional potential common shares issuable under stock options. The weighted average number of shares used in the computation of net income per share was 122,151 in 2013 and 121,495 in 2012 for basic and 122,967 in 2013 and 122,258 in 2012 for diluted.

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Subsequent Events

Management evaluated subsequent events through February 19, 2014, the date the financial statements were available to be issued. Events or transactions occurring after December 31, 2013, but prior to February 19, 2014 that provided additional evidence about conditions that existed at December 31, 2013, have been recognized in the financial statements for the year ended December 31, 2013. Events or transactions that provided evidence about conditions that did not exist at December 31, 2013 but arose before the financial statements were available to be issued, have not been recognized in the financial statements for the year ended December 31, 2013.

NOTE 2 - SECURITIES

The amortized cost and fair value of securities, with gross unrealized gains and losses, at December 31, 2013 and 2012, are as follows:

<u>2013</u>	<u>Amortized cost</u>	<u>Gross unrealized gains</u>	<u>Gross unrealized losses</u>	<u>Fair value</u>
Available-for-sale securities:				
U.S. Treasury bond	\$ 1,066,890	\$ -	\$ 14,390	\$ 1,052,500
U.S. Government and federal agency obligations	10,741,113	56,376	200,843	10,596,646
Obligations of state and political subdivisions	13,584,605	189,220	242,896	13,530,929
Mortgage-backed	8,693,827	160,865	65,635	8,789,057
Bank certificates of deposit	<u>1,482,000</u>	<u>6,252</u>	<u>-</u>	<u>1,488,252</u>
Total available-for-sale securities	<u>\$ 35,568,435</u>	<u>\$ 412,713</u>	<u>\$ 523,764</u>	<u>\$ 35,457,384</u>
<u>2012</u>				
Available-for-sale securities:				
U.S. Treasury bonds	\$ 1,081,922	\$ 11,828	\$ -	\$ 1,093,750
U.S. Government and federal agency obligations	20,066,450	243,936	20,866	20,289,520
Obligations of state and political subdivisions	8,291,705	273,711	6,461	8,558,955
Mortgage-backed	8,919,908	318,928	-	9,238,836
Bank certificates of deposit	<u>1,727,000</u>	<u>5,291</u>	<u>-</u>	<u>1,732,291</u>
Total available-for-sale securities	<u>\$ 40,086,985</u>	<u>\$ 853,694</u>	<u>\$ 27,327</u>	<u>\$ 40,913,352</u>

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 2 - SECURITIES (CONTINUED)

The amortized cost and fair value of securities at December 31, 2013, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<u>Amortized cost</u>	<u>Fair value</u>
Due in one year or less	\$ 2,565,752	\$ 2,584,807
Due after one year through five years	16,778,564	16,872,829
Due after five years through ten years	<u>7,530,292</u>	<u>7,210,691</u>
Total	26,874,608	26,668,327
Mortgage-backed securities	<u>8,693,827</u>	<u>8,789,057</u>
Total available-for-sale securities	<u>\$ 35,568,435</u>	<u>\$ 35,457,384</u>

At December 31, 2013 and 2012, securities with an amortized cost of \$26,860,435 and \$24,177,207, respectively, and a fair value of \$26,663,859 and \$24,555,972, respectively, were pledged to secure borrowing public deposits, borrowings, and for other purposes required or permitted by law.

The following table presents gross unrealized losses and fair value of securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2013 and 2012:

	<u>Securities in a continuous unrealized loss position</u>					
	<u>Less than 12 months</u>		<u>12 months or more</u>		<u>Total</u>	
	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>
<u>2013</u>						
U.S. Treasury Bond	\$ 14,390	\$ 1,052,500	\$ -	\$ -	\$ 14,390	\$ 1,052,500
U.S. Government and federal agency obligations	146,022	3,397,754	54,821	955,509	200,843	4,353,263
Obligations of state and political subdivisions	242,896	5,388,767	-	-	242,896	5,388,767
Mortgage-backed	<u>65,635</u>	<u>4,165,163</u>	<u>-</u>	<u>-</u>	<u>65,635</u>	<u>4,165,163</u>
Total	<u>\$ 468,943</u>	<u>\$ 14,004,184</u>	<u>\$ 54,821</u>	<u>\$ 955,509</u>	<u>\$ 523,764</u>	<u>\$ 14,959,693</u>

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 2 - SECURITIES (CONTINUED)

	<u>Securities in a continuous unrealized loss position</u>					
	<u>Less than</u>		<u>12 months</u>		<u>Total</u>	
	<u>Unrealized</u>	<u>Fair</u>	<u>Unrealized</u>	<u>Fair</u>	<u>Unrealized</u>	<u>Fair</u>
	<u>losses</u>	<u>value</u>	<u>losses</u>	<u>value</u>	<u>losses</u>	<u>value</u>
2012						
U.S. Government and federal agency obligations	\$ 20,866	\$ 2,863,670	\$ -	\$ -	\$ 20,866	\$ 2,863,670
Obligations of state and political subdivisions	<u>6,461</u>	<u>392,854</u>	<u>-</u>	<u>-</u>	<u>6,461</u>	<u>392,854</u>
Total	<u>\$ 27,327</u>	<u>\$ 3,256,524</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 27,327</u>	<u>\$ 3,256,524</u>

There were 25 securities in an unrealized loss position at December 31, 2013, 24 of which were in a loss position less than twelve months. These unrealized losses are considered temporary and were the result of customary and expected fluctuations in the bond market.

Gross realized gains from sales of securities amounted to \$68,825 in 2013 and \$166,344 in 2012, with the income tax provision applicable to such gains amounting to \$23,401 in 2013 and \$56,557 in 2012. There were no gross realized losses from sales of securities in 2013 and 2012.

Restricted stock includes Federal Home Loan Bank of Cincinnati stock of \$853,000 and Federal Reserve Bank stock of \$85,050 at December 31, 2013 and 2012.

NOTE 3 - LOANS

Most of the Bank's lending activities are with customers located in Northwestern and West Central Ohio. As of December 31, 2013 and 2012 the Bank's loans to borrowers in the agriculture industry represent the single largest industry and represented 14% and 15% of the Bank's loan portfolio respectively. Agriculture loans are generally secured by property, equipment, and crop income. Repayment is expected from cash flow from the harvest and sale of crops. Agriculture customers are subject to the risks of weather and market prices of crops which could have an impact on the ability of these customers to repay their loans. Credit losses arising from the Bank's lending experience in the agriculture industry compare favorably with the Bank's loss experience on their loan portfolio as a whole. Credit evaluation of agriculture lending is based on an evaluation of cash flow coverage of principal and interest payments and the adequacy of collateral received.

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 3 - LOANS (CONTINUED)

Certain directors and executive officers, including their immediate families and companies in which they are principal owners, are loan customers of the Bank. Such loans are made in the ordinary course of business in accordance with the normal lending policies of the Bank, including the interest rate charged and collateralization, and do not represent more than a normal collection risk. The following is a summary of activity during 2013 and 2012 for such loans:

	<u>2013</u>	<u>2012</u>
Beginning of year	\$ 43,490	\$ 73,479
Additions	5,824	19,819
Repayments	<u>(36,857)</u>	<u>(49,808)</u>
End of year	<u>\$ 12,457</u>	<u>\$ 43,490</u>

Additions and repayments include loan renewals, as well as net borrowings and repayments under revolving lines-of-credit.

The following is a summary of activity in the allowance for loan losses, as well as the Bank's recorded investment in loans, by portfolio segment and based on impairment method, as of and for the years ended December 31, 2013 and 2012:

	<u>Real estate mortgage</u>					<u>Total</u>
	<u>Commercial</u>	<u>Consumer</u>	<u>Commercial</u>	<u>Residential</u>	<u>Home equity</u>	
<u>Allowance for Loan Losses:</u>						
Balance at January 1, 2013	\$ 153,498	\$ 34,071	\$ 744,550	\$ 361,244	\$ 94,930	\$ 1,388,293
Provision (credit) for loan losses	9,426	(8,489)	45,930	67,831	5,302	120,000
Loans charged off	-	(15,099)	-	(36,835)	-	(51,934)
Recoveries	<u>-</u>	<u>15,686</u>	<u>49,139</u>	<u>13,437</u>	<u>-</u>	<u>78,262</u>
Balance at December 31, 2013	162,924	26,169	839,619	405,677	100,232	1,534,621
Ending balance individually evaluated for impairment	<u>-</u>	<u>-</u>	<u>129,137</u>	<u>-</u>	<u>-</u>	<u>129,137</u>
Ending balance collectively evaluated for impairment	<u>\$ 162,924</u>	<u>\$ 26,169</u>	<u>\$ 710,482</u>	<u>\$ 405,677</u>	<u>\$ 100,232</u>	<u>\$ 1,405,484</u>

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 3 - LOANS (CONTINUED)

2013

	<u>Real estate mortgage</u>					<u>Total</u>
	<u>Commercial</u>	<u>Consumer</u>	<u>Commercial</u>	<u>Residential</u>	<u>Home equity</u>	
Loans:						
Ending balance	\$ 19,864,723	\$ 3,100,982	\$ 48,745,535	\$ 12,082,041	\$ 8,978,220	\$ 92,771,501
Ending balance individually evaluated for impairment	<u>50,000</u>	<u>-</u>	<u>2,221,724</u>	<u>210,872</u>	<u>-</u>	<u>2,482,596</u>
Ending balance collectively evaluated for impairment	<u>\$ 19,814,723</u>	<u>\$ 3,100,982</u>	<u>\$ 46,523,811</u>	<u>\$ 11,871,169</u>	<u>\$ 8,978,220</u>	<u>\$ 90,288,905</u>

2012

Allowance for Loan Losses:

Balance at January 1, 2012	\$ 262,998	\$ 25,199	\$ 584,637	\$ 246,417	\$ 125,107	\$ 1,244,358
Provision (credit) for loan losses	(109,500)	13,258	215,144	266,008	(34,910)	350,000
Loans charged off	-	(21,166)	(104,177)	(158,869)	-	(284,212)
Recoveries	-	16,780	48,946	7,688	4,733	78,147
Balance at December 31, 2012	<u>153,498</u>	<u>34,071</u>	<u>744,550</u>	<u>361,244</u>	<u>94,930</u>	<u>1,388,293</u>
Ending balance individually evaluated for impairment	<u>-</u>	<u>-</u>	<u>277,318</u>	<u>-</u>	<u>-</u>	<u>277,318</u>
Ending balance collectively evaluated for impairment	<u>\$ 153,498</u>	<u>\$ 34,071</u>	<u>\$ 467,232</u>	<u>\$ 361,244</u>	<u>\$ 94,930</u>	<u>\$ 1,110,975</u>

Loans:

Ending balance	\$ 19,834,157	\$ 2,766,034	\$ 40,156,319	\$ 10,952,116	\$ 8,289,192	\$ 81,997,818
Ending balance individually evaluated for impairment	<u>-</u>	<u>-</u>	<u>1,184,384</u>	<u>173,367</u>	<u>12,393</u>	<u>1,370,144</u>
Ending balance collectively evaluated for impairment	<u>\$ 19,834,157</u>	<u>\$ 2,766,034</u>	<u>\$ 38,971,935</u>	<u>\$ 10,778,749</u>	<u>\$ 8,276,799</u>	<u>\$ 80,627,674</u>

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 3 - LOANS (CONTINUED)

Construction loans are underwritten utilizing independent appraisals, sensitivity analysis of absorption, vacancy and lease rates and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of funds with repayment substantially dependent on the success of the ultimate project. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, general economic conditions and the availability of long-term financing. The Bank may require guarantees on these loans. The Bank's construction loans are secured primarily by properties located in its primary market area.

The Bank originates 1 – 4 family real estate and consumer loans utilizing credit reports to supplement the underwriting process. The Bank's manual underwriting standards for 1 – 4 family loans are generally in accordance with FLMC and FNMA manual underwriting guidelines. Properties securing 1 – 4 family real estate loans are appraised by either staff appraisers or fee appraisers, both of which are independent of the loan origination function and have been approved by the Board of Directors. The loan-to-value ratios normally do not exceed 80% without credit enhancements such as mortgage insurance. The Bank will lend up to 100% of the lesser of the appraised value or purchase price for conventional 1 – 4 family real estate loans, provided private mortgage insurance is obtained. The underwriting standards for consumer loans include a determination of the applicant's payment history on other debts and an assessment of their ability to meet existing obligations and payments on the proposed loan. To monitor and manage loan risk, policies and procedures are developed and modified, as needed by management. This activity, coupled with smaller loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, market conditions are reviewed by management on a regular basis. The Bank's 1 – 4 family real estate loans are secured primarily by properties located in its primary market area.

Commercial and agricultural real estate loans are subject to underwriting standards and processes similar to commercial and agricultural operating loans, in addition to those unique to real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial and agricultural real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Loan to value is generally 75% of the cost or value of the assets. Appraisals on properties securing these loans are generally performed by fee appraisers approved by the Board of Directors. Because payments on commercial and agricultural real estate loans are often dependent on the successful operation or management of the properties, repayment of such loans may be subject to adverse conditions in the real estate market or the economy. Management monitors and evaluates commercial and agricultural real estate loans based on collateral and risk rating criteria. The Bank may require guarantees on these loans. The Bank's commercial and agricultural real estate loans are secured primarily by properties located in its primary market area.

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 3 - LOANS (CONTINUED)

Commercial and agricultural operating loans are underwritten based on the Bank's examination of current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. This underwriting includes the evaluation of cash flows of the borrower, underlying collateral, if applicable, and the borrower's ability to manage its business activities. The cash flows of borrowers and the collateral securing these loans may fluctuate in value after the initial evaluation. A first priority lien on the general assets of the business normally secures these types of loans. Loan to value limits vary and are dependent upon the nature and type of the underlying collateral and the financial strength of the borrower. Crop and hail insurance is required for most agricultural borrowers. Loans are generally guaranteed by the principal(s). The Bank's commercial and agricultural operating lending is principally in its primary market area.

The Bank has an internal credit analyst who reviews and validates credit risk on a periodic basis, as well as an external loan review performed annually or semi-annually. Results of the credit analyst and external loan reviews are presented to management and the Audit Committee. The credit analyst and loan review processes compliment and reinforce the risk identification and assessment decisions made by lenders and credit personnel, as well as the Bank's policies and procedures.

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2013 and 2012:

	<u>2013</u>		<u>2012</u>	
	<u>Unpaid principal balance</u>	<u>Allowance for loan losses allocated</u>	<u>Unpaid principal balance</u>	<u>Allowance for loan losses allocated</u>
With an allowance recorded:				
Real estate:				
Commercial	\$ 799,087	\$ 129,137	\$ 875,534	\$ 277,318
With no related allowance recorded:				
Real estate:				
Commercial	1,422,637	-	308,850	-
Residential	210,872	-	173,367	-
Home equity	-	-	12,393	-
Commercial	<u>50,000</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 2,482,596</u>	<u>\$ 129,137</u>	<u>\$ 1,370,144</u>	<u>\$ 277,318</u>

No additional funds are committed to be advanced in connection with impaired loans at December 31, 2013 and 2012.

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 3 - LOANS (CONTINUED)

The following is a summary of information for the years ended December 31, 2013 and 2012 pertaining to impaired loans:

	<u>2013</u>	<u>2012</u>
Average investment in impaired loans	\$ 1,435,869	\$ 1,262,470
Interest income recognized on impaired loans	36,977	17,253
Interest income recognized on a cash basis on impaired loans	36,977	17,253

Included in impaired loans at December 31, 2013 and 2012 were commercial real estate loans with outstanding balances aggregating \$2,271,724 and \$984,497, respectively, that have been modified in troubled debt restructurings. The Corporation has allocated specific reserves of \$129,137 and \$277,318 at December 31, 2013 and 2012, respectively, to these loans. The Corporation intends to lend no additional amounts to these customers. There were two new TDRs occurring during 2013.

The following table presents the aging of the recorded investment in past due and nonaccrual loans for the years ended December 31, 2013 and 2012 by class of loans:

	<u>Loans past due accruing interest</u>				<u>Loans on non- accrual</u>	<u>Loans not past due or on non-accrual</u>	<u>Total</u>
	<u>30 – 59 days</u>	<u>60 – 89 days</u>	<u>Over 90 days</u>	<u>Total</u>			
<u>2013</u>							
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 19,864,723	\$ 19,864,723
Real estate:							
Commercial	97,363	-	-	97,363	901,188	47,746,984	48,745,535
Home Equity	-	-	-	-	-	8,978,220	8,978,220
Residential	-	-	-	-	210,872	11,871,169	12,082,041
Consumer	<u>11,941</u>	<u>8,144</u>	<u>-</u>	<u>20,085</u>	<u>-</u>	<u>3,080,897</u>	<u>3,100,982</u>
Total	<u>\$ 109,304</u>	<u>\$ 8,144</u>	<u>\$ -</u>	<u>\$ 117,448</u>	<u>\$ 1,112,060</u>	<u>\$ 91,541,993</u>	<u>\$ 92,771,501</u>
<u>2012</u>							
Commercial	\$ 42,344	\$ -	\$ -	\$ 42,344	\$ -	\$ 19,791,813	\$ 19,834,157
Real estate:							
Commercial	-	-	-	-	1,184,384	38,971,935	40,156,319
Home Equity	22,490	-	-	22,490	12,393	8,254,309	8,289,192
Residential	123,253	107,359	59,877	290,489	173,367	10,488,260	10,952,116
Consumer	<u>3,126</u>	<u>16,253</u>	<u>-</u>	<u>19,379</u>	<u>-</u>	<u>2,746,655</u>	<u>2,766,034</u>
Total	<u>\$ 191,213</u>	<u>\$ 123,612</u>	<u>\$ 59,877</u>	<u>\$ 374,702</u>	<u>\$ 1,370,144</u>	<u>\$ 80,252,972</u>	<u>\$ 81,997,818</u>

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 3 - LOANS (CONTINUED)

Credit Quality Indicators:

The Company 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 Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes all loans from the commercial loan department. This analysis is performed at least annually. The Company 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 Company'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 Company 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 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, 2013 and 2012, based on the most recent analysis performed, the risk category of loans by class of loans was as follows:

<u>2013</u>	<u>Pass</u>	<u>Special mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
Commercial	\$ 19,607,761	\$ -	\$ 256,962	\$ -	\$ 19,864,723
Real estate:					
Commercial	45,524,281	-	3,221,254	-	48,745,535
Home Equity	8,819,031	-	159,189	-	8,978,220
Residential	11,586,735	-	495,306	-	12,082,041
Consumer	<u>3,093,394</u>	<u>-</u>	<u>7,588</u>	<u>-</u>	<u>3,100,982</u>
Total	<u>\$ 88,631,202</u>	<u>\$ -</u>	<u>\$ 4,140,299</u>	<u>\$ -</u>	<u>\$ 92,771,501</u>

PANDORA BANCSHARES, INC.
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NOTE 3 - LOANS (CONTINUED)

<u>2012</u>	<u>Pass</u>	<u>Special mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
Commercial	\$ 19,459,810	\$ 84,616	\$ 289,731	\$ -	\$ 19,834,157
Real estate:					
Commercial	36,460,008	899,022	2,797,289	-	40,156,319
Home Equity	8,089,501	-	199,691	-	8,289,192
Residential	10,952,116	-	-	-	10,952,116
Consumer	<u>2,766,034</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,766,034</u>
Total	<u>\$ 77,727,469</u>	<u>\$ 983,638</u>	<u>\$ 3,286,711</u>	<u>\$ -</u>	<u>\$ 81,997,818</u>

At December 31, 2013, the Company had various loans that were modified in troubled debt restructurings and impaired. Newly classified troubled debt restructurings during the year ended December 31, 2013 consisted of the following:

	<u>Number of loans</u>	<u>Recorded balance</u>
Commercial	1	\$ 50,000
Commercial real estate	4	<u>1,320,536</u>
Total		<u>\$ 1,370,536</u>

The pre and post-modification recorded balances for these loans were the same. There were no loans that were modified in troubled debt restructurings and impaired during 2013 and 2012.

The troubled debt restructurings described above resulted in no increase to the allowance for loan losses and resulted in no charge-offs during the years ended December 31, 2013 and 2012. The newly restructured loans referenced above were modified with a reduced interest rate, interest-only payment terms, and/or a modification to other repayment terms.

NOTE 4 - PREMISES AND EQUIPMENT

A summary of the cost and accumulated depreciation of premises and equipment consists of the following at December 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Land	\$ 1,084,023	\$ 1,084,023
Buildings and building improvements	4,796,421	4,788,056
Furniture, fixtures, and equipment	<u>1,158,798</u>	<u>1,294,294</u>
Total cost	7,039,242	7,166,373
Less accumulated depreciation	<u>3,059,393</u>	<u>3,037,807</u>
Net premises and equipment	<u>\$ 3,979,849</u>	<u>\$ 4,128,566</u>

PANDORA BANCSHARES, INC.
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NOTE 4 - PREMISES AND EQUIPMENT (CONTINUED)

Depreciation of premises and equipment for the years ended December 31, 2013 and 2012 amounted to \$211,602 and \$199,991, respectively.

The Company has entered into an agreement to lease the land serving as the site for its Findlay East branch. Rent expense under the lease, which expires December 31, 2020, amounted to \$20,000 in 2013 and 2012. Future commitments at December 31, 2013 under the lease aggregated \$140,000 with \$20,000 payable annually through 2020. The Company has renewal options to extend the lease through December 31, 2050.

NOTE 5 - SECONDARY MARKET LENDING

Mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balance of mortgage loans serviced for others approximated \$81,024,000 and \$79,838,000 at December 31, 2013 and 2012, respectively.

The balance of capitalized servicing rights included in other assets amounted to \$543,484 and \$565,741 at December 31, 2013 and 2012, respectively.

During the years ended December 31, 2013 and 2012, the Bank capitalized \$149,860 and \$306,090, respectively, of servicing rights and such amounts are included in gain on sale of loans. Amortization of mortgage servicing rights amounted to \$172,117 in 2013 and \$225,538 in 2012.

NOTE 6- DEPOSITS

The aggregate amount of time deposits in denominations of \$100,000 or more at December 31, 2013 and 2012 approximated \$21,804,000 and \$17,973,000, respectively. Interest expense on these deposits amounted to \$139,951 in 2013 and \$205,110 in 2012.

At December 31, 2013, the scheduled maturities of time deposits are as follows:

2014	\$ 30,672,391
2015	8,224,289
2016	6,499,682
2017	1,222,493
2018	711,780
Thereafter	<u>53,884</u>
Total	<u>\$ 47,384,519</u>

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NOTE 7 - FEDERAL HOME LOAN BANK BORROWINGS

Federal Home Loan Bank borrowings consist of the following at December 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Secured note, with interest at 2.70%, due October 2013	\$ -	\$ 2,500,000
Secured note, with interest at .92%, due October 2014	1,500,000	1,500,000
Secured note, with interest at 2.82%, due January 2015	1,000,000	1,000,000
Advances secured by individual residential mortgages under blanket agreement	<u>3,023,170</u>	<u>41,633</u>
Total Federal Home Loan Bank borrowings	<u>\$ 5,523,170</u>	<u>\$ 5,041,633</u>

Interest on advances outstanding at December 31, 2013 secured by individual mortgages under blanket agreement ranged from 1.08% to 7.00 %, with interest payable monthly and maturities ranging through August 2028. The weighted average interest rate of Federal Home Loan Bank borrowings outstanding at December 31, 2013 and 2012 was 1.64% and 2.23%, respectively. Borrowings are secured by mortgage loans approximating \$17,321,000 as of December 31, 2013. Advances are subject to prepayment penalties and the provisions and conditions of the credit policy of the Federal Home Loan Bank.

Future maturities of Federal Home Loan Bank borrowings at December 31, 2013, are as follows:

2014	\$ 2,000,693
2015	1,414,379
2016	359,109
2017	310,553
2018	266,741
Thereafter	<u>1,171,695</u>
Total	<u>\$ 5,523,170</u>

NOTE 8 - INCOME TAXES

The provision for income taxes for the years ended December 31, 2013 and 2012 consist of the following:

	<u>2013</u>	<u>2012</u>
Current provision	\$ 220,079	\$ 125,002
Deferred credit	<u>(76,379)</u>	<u>(6,902)</u>
Total provision for income taxes	<u>\$ 143,700</u>	<u>\$ 118,100</u>

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 8 - INCOME TAXES (CONTINUED)

The income tax provision attributable to income from operations differed from the amounts computed by applying the U.S. federal income tax rate of 34% to income before income taxes as a result of the following:

	<u>2013</u>	<u>2012</u>
Expected tax using statutory tax rate of 34%	\$ 227,900	\$ 197,700
Increase (decrease) resulting from:		
Tax-exempt interest income, net of interest expense associated with cost to carry	(64,700)	(53,400)
Tax-exempt income on life insurance policies, net of premiums paid	(24,400)	(31,100)
Other, net	<u>4,900</u>	<u>4,900</u>
Total provision for income taxes	<u>\$ 143,700</u>	<u>\$ 118,100</u>

The deferred income tax credit of \$76,379 in 2013 and of \$6,902 in 2012 resulted from the tax effects of temporary differences. There was no impact for changes in tax laws and rates or changes in the valuation allowance for deferred tax assets.

The components of deferred tax assets and liabilities consist of the following at December 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Deferred tax assets:		
Net unrealized loss on securities available-for-sale	\$ 37,757	\$ -
Allowance for loan losses	445,800	396,100
Accrued employee benefits	246,900	233,500
Other	<u>36,543</u>	<u>-</u>
Total deferred tax assets	<u>767,000</u>	<u>629,600</u>
Deferred tax liabilities:		
Net unrealized gain on securities available-for-sale	-	280,964
Federal Home Loan Bank stock dividends	146,900	146,900
Depreciation	87,000	80,000
Mortgage servicing rights	184,800	192,400
Other	<u>25,200</u>	<u>1,336</u>
Total deferred tax liabilities	<u>443,900</u>	<u>701,600</u>
Net deferred tax assets (liabilities)	<u>\$ 323,100</u>	<u>\$ (72,000)</u>

Net deferred tax assets are included in other assets and net deferred tax liabilities are included in other liabilities in the accompanying consolidated balance sheets.

The federal income tax returns of the Corporation that remain open and subject to examination at December 31, 2013 are years 2010 – 2013. Management does not believe the Corporation has any significant uncertain tax positions at December 31, 2013.

Management believes it is more likely than not that the benefit of deferred tax assets will be realized. Therefore, no valuation allowance for deferred tax assets is deemed necessary as of December 31, 2013 and 2012.

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 9 - EMPLOYEE BENEFIT PLANS

The Corporation sponsors a defined contribution 401(k) plan for the benefit of eligible employees. Substantially all employees participate in the plan. Employer contributions are discretionary as determined by the Board of Directors and may be basic, optional, and/or matching in nature. Basic and optional contributions are allocated to participants based on the relative compensation of each participant. Matching contributions are determined as a percentage of participating employee contributions. Participants are immediately vested in employer basic and matching contributions. Employer matching contributions amounted to \$48,708 in 2013 and \$51,167 in 2012. There were no basic or optional employer contributions made during 2013 or 2012.

Under an employee stock purchase plan, eligible employees may defer a portion of their compensation and use the proceeds to purchase stock of the Corporation at a discount determined by the Board of Directors as stipulated in the plan. The Corporation sold from treasury 267 shares of stock in 2013 and 306 shares in 2012 under the plan.

The Bank has entered into various agreements with certain directors to provide for supplemental retirement benefits under deferred board of director fees, as specified by the individuals. The agreements provide for monthly retirement benefits based on the value of the individual's deferred compensation account. As of December 31, 2013 and 2012, the Bank's liability for such deferred compensation payments amounted to \$512,782 and \$482,206, respectively. The Bank has also entered into agreements with certain officers and directors to provide for supplemental retirement benefits. The Bank has provided a liability for estimated accumulated supplemental retirement benefits of \$150,997 at December 31, 2013 and \$123,985 at December 31, 2012. The Bank has established a non-qualified deferred compensation plan for four senior officers which provides for deferred compensation benefits in the event the individuals attain certain annual goals established in the plan. The Bank has provided a liability for accumulated deferred compensation benefits under the plan amounting to \$51,221 and \$69,081, respectively, as of December 31, 2013 and 2012.

The Bank has purchased life insurance policies on such individuals, as well as certain previously terminated participants, to assist in funding future deferred compensation obligations. The aggregate cash surrender value of life insurance policies amounted to \$3,123,798 and \$3,052,122 at December 31, 2013 and 2012, respectively.

NOTE 10 - STOCK OPTIONS

Under the Corporation's Stock Option Plan, the Corporation may grant options to its directors, officers, and employees for up to 30,551 shares of common stock, 21,252 of which have been granted and exercised as of December 31, 2013. Both incentive stock options and nonqualified stock options may be granted under the plan. The exercise price of each option equals the market price of the Corporation's stock on the date of grant, and an option's maximum term is 10 years.

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 10 - STOCK OPTIONS (CONTINUED)

A summary of activity in the plan for the years ended December 31, 2013 and 2012 is as follows:

	<u>2013</u>		<u>2012</u>	
	<u>Shares</u>	<u>Weighted average exercise price</u>	<u>Shares</u>	<u>Weighted average exercise price</u>
Outstanding at beginning of year	7,400	\$ 60.99	7,400	\$ 60.99
Exercised	(1,433)	(58.76)	-	-
Forfeited	(2,400)	(67.00)	-	-
Outstanding at end of year	<u>3,567</u>	<u>\$ 57.84</u>	<u>7,400</u>	<u>\$ 60.99</u>
Options exercisable at end of year	<u>3,527</u>	<u>\$ 57.81</u>	<u>7,200</u>	<u>\$ 61.00</u>

Additional information pertaining to options outstanding at December 31, 2013 is as follows:

<u>Exercise Price</u>	<u>Outstanding</u>		<u>Exercisable</u>	
	<u>Number</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Number</u>	<u>Weighted Average Exercise Price</u>
\$ 57.50	3,167	1.1	3,167	\$ 57.50
\$ 60.50	<u>400</u>	<u>.2</u>	<u>360</u>	<u>60.50</u>
Total	<u>3,567</u>	<u>1.1</u>	<u>3,527</u>	<u>\$ 57.81</u>

NOTE 11 - FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit, and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheet. The Bank's exposure to credit loss is represented by the contractual amount of these commitments. The Bank follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

	<u>December 31, contract amount</u>	
	<u>2013</u>	<u>2012</u>
Commitments to extend credit, including unfunded commitments under lines of credit	\$ 14,131,000	\$ 13,358,000
Commercial and standby letters of credit	433,000	465,000

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 11 - FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK (CONTINUED)

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the customer.

Unfunded commitments under commercial lines of credit, revolving credit lines, and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are collateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Bank is committed.

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those letters of credit are used primarily to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved is extending loan facilities to customers. The Bank generally holds collateral supporting those commitments if deemed necessary. The amount and nature of the collateral obtained are based on the Bank's credit evaluation of the customer. Collateral held varies but may include cash, securities, accounts receivable, inventory, property, plant, and equipment, and real estate.

NOTE 12 - REGULATORY MATTERS

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier I capital to average assets (as defined). Management believes, as of December 31, 2013 and 2012, that the Bank met all capital adequacy requirements to which it is subject.

As of December 31, 2013, the most recent notification from federal banking agencies categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized", an institution must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the Bank's category.

PANDORA BANCSHARES, INC.
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NOTE 12 - REGULATORY MATTERS (CONTINUED)

The actual capital amounts and ratios of the Bank as of December 31, 2013 and 2012 are presented in the following table:

	<u>Actual</u>		<u>Minimum capital requirement</u>		<u>Minimum 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>
As of December 31, 2013						
Total Capital (to Risk-Weighted Assets)	\$ 13,006	12.5%	\$ 8,332	≥ 8.0%	\$10,415	≥ 10.0%
Tier I Capital (to Risk-Weighted Assets)	\$ 11,701	11.2%	\$ 4,166	≥ 4.0%	\$ 6,249	≥ 6.0%
Tier I Capital (to Average Assets)	\$ 11,701	8.1%	\$ 5,765	≥ 4.0%	\$ 7,206	≥ 5.0%
As of December 31, 2012						
Total Capital (to Risk-Weighted Assets)	\$ 12,548	13.2%	\$ 7,604	≥ 8.0%	\$ 9,506	≥ 10.0%
Tier I Capital (to Risk-Weighted Assets)	\$ 11,357	12.0%	\$ 3,802	≥ 4.0%	\$ 5,703	≥ 6.0%
Tier I Capital (to Average Assets)	\$ 11,357	8.0%	\$ 5,651	≥ 4.0%	\$ 7,064	≥ 5.0%

On a parent company only basis, the Corporation's primary source of funds is dividends paid by the Bank. The ability of the Bank to pay dividends is subject to limitations under various laws and regulations, and to prudent and sound banking principles. Generally, subject to certain minimum capital requirements, the Bank may declare dividends without the approval of the Office of the Comptroller of the Currency, unless the total dividends in a calendar year exceed the total of the Bank's net profits for the year combined with its retained profits of the two preceding years.

The Board of Governors of the Federal Reserve System generally considers it to be an unsafe and unsound banking practice for a bank holding company to pay dividends except out of current operating income, although other factors such as overall capital adequacy and projected income may also be relevant in determining whether dividends should be paid.

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NOTE 13 - FAIR VALUE MEASUREMENTS

FASB ASC 820-10, *Fair Value Measurements*, requires the use of valuation techniques that should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable or unobservable. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources. Unobservable inputs reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, ASC 820-10 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 – Quoted prices in active markets for identical assets or liabilities that the Corporation has the ability to access at the measurement date.

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability; and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 – Unobservable inputs for the asset or liability for which there is little, if any, market activity at the measurement date. Unobservable inputs reflect the Corporation's own assumptions about what market participants would use to price the asset or liability. The inputs are developed based on the best information available in the circumstances, which might include the Corporation's own financial data such as internally developed pricing models, discounted cash flow methodologies, as well as instruments for which the fair value determination requires significant management judgment.

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 13 - FAIR VALUE MEASUREMENTS (CONTINUED)

The following table summarizes financial assets (there were no financial liabilities) measured at fair value as of December 31, 2013 and 2012, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	<u>Level 1 inputs</u>	<u>Level 2 inputs</u>	<u>Level 3 inputs</u>	<u>Total fair value</u>
2013				
Recurring – securities available-for-sale:				
U.S. Treasury bonds	\$ 1,052,500	\$ -	\$ -	\$ 1,052,500
U.S. Government and federal agency obligations	-	10,596,646	-	10,596,646
Obligations of state and political subdivisions	-	13,530,929	-	13,530,929
Mortgage-backed Bank certificates of deposit	-	8,789,057	-	8,789,057
	<u>-</u>	<u>1,488,252</u>	<u>-</u>	<u>1,488,252</u>
Total recurring	<u>\$ 1,052,500</u>	<u>\$ 34,404,884</u>	<u>\$ -</u>	<u>\$ 35,457,384</u>
Nonrecurring:				
Impaired loans	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,353,459</u>	<u>\$ 2,353,459</u>
2012				
Recurring – securities available-for-sale:				
U.S. Treasury bonds	\$ 1,093,750	\$ -	\$ -	\$ 1,093,750
U.S. Government and federal agency obligations	-	20,289,520	-	20,289,520
Obligations of state and political subdivisions	-	8,558,955	-	8,558,955
Mortgage-backed Bank certificates of deposit	-	9,238,836	-	9,238,836
	<u>-</u>	<u>1,732,291</u>	<u>-</u>	<u>1,732,291</u>
Total recurring	<u>\$ 1,093,750</u>	<u>\$ 39,819,602</u>	<u>\$ -</u>	<u>\$ 40,913,352</u>
Nonrecurring:				
Other real estate owned	\$ -	\$ -	\$ 66,947	\$ 66,947
Impaired loans	<u>-</u>	<u>-</u>	<u>1,092,826</u>	<u>1,092,826</u>
Total nonrecurring	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,159,773</u>	<u>\$ 1,159,773</u>

PANDORA BANCSHARES, INC.
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NOTE 13 - FAIR VALUE MEASUREMENTS (CONTINUED)

Impaired loans are reported net of an allowance for loan losses of \$129,137 in 2013 and \$277,318 in 2012.

There were no financial instruments measured at fair value that moved to a lower level in the fair value hierarchy during 2013 and 2012 due to the lack of observable quotes in inactive markets for those instruments at December 31, 2013 and 2012.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, follows.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality, the Corporation's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Corporation's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Corporation's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Securities Available-for-Sale

Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities typically include U.S. treasury bonds. If quoted market prices are not available, then fair values are estimated using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. Examples of such instruments, which would generally be classified within Level 2 of the valuation hierarchy, include municipal bonds, agency and mortgage-backed securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. The Corporation did not have any available-for-sale securities classified as Level 3 as of and for the years ended December 31, 2013 and 2012.

Impaired Loans

The Corporation does not record impaired loans at fair value on a recurring basis. However, periodically, a loan is considered impaired and is reported at the fair value of the underlying collateral, less estimated costs to sell, if repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs, including recent appraisals and Level 3 inputs based on customized discounting criteria. Due to the significance of the Level 3 inputs, impaired loans fair values have been classified as Level 3.

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NOTE 13 - FAIR VALUE MEASUREMENTS (CONTINUED)

Other Real Estate Owned

The Bank values other real estate owned at the estimated fair value of the underlying collateral less expected selling costs. Such values are estimated primarily using appraisals and reflect a market value approach. Due to the significance of the Level 3 inputs, other real estate owned has been classified as Level 3.

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances, for example, when there is evidence of impairment. Financial assets and financial liabilities, excluding impaired loans and other real estate owned, measured at fair value on a nonrecurring basis were not significant at December 31, 2013 and 2012.

NOTE 14 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated carrying amounts and related fair values of financial instruments at December 31, 2013 and 2012, are as follows:

	<u>2013</u>		<u>2012</u>	
	<u>Carrying amount</u>	<u>Estimated fair value</u>	<u>Carrying amount</u>	<u>Estimated fair value</u>
Financial assets:				
Cash and cash equivalents	\$ 9,817,227	\$ 9,817,227	\$ 8,940,198	\$ 8,940,198
Securities, including restricted stock	36,436,434	36,436,434	41,892,402	41,892,402
Loans, net (including loans held for sale)	91,473,280	95,173,000	80,998,678	85,341,000
Accrued interest receivable	633,179	633,179	640,792	640,792
Financial liabilities:				
Deposits	127,592,612	127,926,000	122,203,423	122,748,000
FHLB borrowings	5,523,170	5,299,000	5,041,633	5,115,000
Accrued interest payable	27,006	27,006	32,261	32,261

The above summary does not include mortgage servicing rights, cash surrender value of life insurance and other liabilities which are also considered financial instruments. The estimated fair value of such items is considered to closely approximate their carrying amounts.

There are also unrecognized financial instruments at December 31, 2013 and 2012 which relate to commitments to extend credit and letters of credit. The contract amount of such financial instruments amounts to \$14,564,000 at December 31, 2013 and \$13,823,000 at December 31, 2012. Such amounts are also considered to be the estimated fair values.

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 14 - FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The following methods and assumptions were used to estimate the fair value of each class of financial instruments shown above:

Cash and cash equivalents:

Fair value is determined to be the carrying amount for these items because they represent cash or mature in 90 days or less and do not represent unanticipated credit concerns.

Securities:

Fair value is determined based on quoted market prices of the individual securities or, if not available, estimated fair value was obtained by comparison to other known securities with similar risk and maturity characteristics. Such value does not consider possible tax ramifications or estimated transaction costs. The carrying value of restricted stock approximates fair value based on the redemption provisions of the entities.

Loans:

Fair value was estimated for portfolios of loans with similar financial characteristics. For adjustable rate loans, which re-price at least annually and generally possess low risk characteristics, the carrying amount is believed to be a reasonable estimate of fair value. For fixed rate loans the fair value is estimated based on a discounted cash flow analysis, considering weighted average rates and terms of the portfolio, adjusted for credit and interest rate risk inherent in the loans. Fair value for nonperforming loans is based on recent appraisals or estimated discounted cash flows. The estimated value of credit card loans is based on existing loans and does not include the value that relates to estimated cash flows from new loans generated from existing cardholders over the remaining life of the portfolio.

Deposit liabilities:

The fair value of core deposits, including demand deposits, savings accounts, and certain money market deposits, is the amount payable on demand. The fair value of fixed-maturity certificates of deposit is estimated using the rates offered at year end for deposits of similar remaining maturities. The estimated fair value does not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the marketplace.

Other financial instruments:

The fair value of commitments to extend credit and letters of credit is determined to be the contract amount, since these financial instruments generally represent commitments at existing rates. The fair value of other borrowings is determined based on a discounted cash flow analysis using current interest rates.

PANDORA BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 14 - FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Other financial instruments, continued:

The fair value estimates of financial instruments are made at a specific point in time based on relevant market information. These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings of a particular financial instrument over the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Since no ready market exists for a significant portion of the financial instruments, fair value estimates are largely based on judgments after considering such factors as future expected credit losses, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect these estimates.

NOTE 15 - CONTINGENT LIABILITIES

In the normal course of business, the Corporation and Bank may be involved in various legal actions, but in the opinion of management and legal counsel, the ultimate disposition of such matters is not expected to have a material adverse effect on the consolidated financial statements.

This information is an integral part of the accompanying consolidated financial statements.

Directors

Charles Niswander, Chairman; retired from Blanchard Valley Health System
Donald Dreisbach, Vice Chairman; retired Vice President of Sky Bank
David Rodabaugh, Secretary and Treasurer; Attorney at Law
Todd A. Mason, President and Chief Executive Officer
Martin Terry, Vice President, Business Affairs, University of Findlay
J. Peter Suter, Associate Professor of Business at Bluffton University
Jared Lehman, Executive Director Otterbein Cridersville
Randal J. Verhoff, CPA, Verhoff & Company, LLC

Executive Officer of Pandora Bancshares, Inc.

Todd A. Mason, President and Chief Executive Officer

Executive Officers of First National Bank of Pandora

Todd A. Mason, President and Chief Executive Officer
Larry E. Hoffman, Senior Vice President and Chief Financial Officer
Mark DePue, Senior Vice President
Brendon Matthews, Senior Vice President

Annual Meeting

April 26, 2014 – 10:00 a.m.
Findlay Country Club
1500 Country Club Drive
Findlay, OH 45840

Investor Information:

Investors, analysts and others
seeking financial information may
contact:

Todd A. Mason, CEO
Pandora Bancshares, Inc.
102 E. Main St.
Pandora, Ohio 45877

Bank Locations:

First National Bank
102 E. Main St.
Pandora, OH 45877
419-384-3221

First National Bank
112 Cherry St.
Bluffton, OH 45817
419-358-5500

First National Bank
1630 Tiffin Ave.
Findlay, OH 45840
419-429-6000

First National Bank
1114 Trenton Ave,
Findlay, OH 45840
419-425-2500

Officers and Employees As of December 31, 2013

Todd A. Mason	President and Chief Executive Officer
Larry E. Hoffman	Senior Vice President and Chief Financial Officer
Mark DePue	Senior Vice President
Brendon Matthews	Senior Vice President
Chris Alexander	Vice President
Nita Crawford	Vice President/Human Resources
Patricia Garlock	Vice President
Doug Shaneyfelt	Vice President/IT
Vanessa Greer	Assistant Vice President
Janet Kingen	Assistant Vice President
Susan Pancake	Assistant Vice President
Kimberly Reese	Assistant Vice President
Vicki Rossman	Assistant Vice President
Shari Schwab	Assistant Vice President
Amy Searfoss	Assistant Vice President

Heidi Allen
Michael Bell
Casandra Bennett
Sally Burris
Dave Culver
Deborah Diller
Chris Eaton
Devin Ellerbrock
Linda Fleming
Elizabeth Gross
Megan Hochstettler
Amy Laibe
Kara Leonard
Kristine Lowry
Abbie Loy
Debra Mack
Kelly McCluer
Jennifer Mershman
Jessica Meyer
Angie Morman
Brenda Palovcik
Victoria Parsons
Barbara Ranes
Laura Schwab
Terry Sears
Jeff Stratton
Stacy Stumbaugh
Adrienne Warren
Sharla Welty

Directors of the First National Bank of Pandora and Pandora Bancshares, Inc.

P. D. Bixel, MD 1919, 1934 – 1937	Irwin Hilty 1953 – 1968	Burnette Powell 1986 – 1987
Carl Grismore 1919	Francis C. Marshall* 1953 – 1973	Malcolm Basinger 1987 – 1999
J. A. Huffman 1919 – 1924	John H. Styer 1955 – 1969	David Emans 1988 – 2008
Noah Schumacher 1919 - 1933	Randall C. Etling 1956 – 1973	Mary S. Amstutz 1989 – 2001
C. Henry Smith* 1919 – 1948	Lowell E. Hatfield* 1956 – 1961, 1964 – 1986	Harold Van Scoder 1990 – 1996
P.C. Steiner 1919 – 1933	Francis Kempf 1957 – 1963	Douglas Edinger 1994 – 2006
M. I. Trostle* 1919 – 1957	Milo B. Rice, MD* 1962-1973	Paul Freeman* 1992 – 2002
Louis Basinger 1920 – 1922	Edward E. Schutz 1962	David Rodabaugh 1994 – Present
Otto McDowell 1920 – 1922	Warren Bridenbaugh* 1963 – 1979	James Stechschulte 1995 – 2003
Elmer Campbell 1923 – 1924	Daniel W. Cook 1969 – 1984	Charles Niswander 1997 – Present
J.A. Schutz 1923 – 1937	Grover Geiger, Jr.* 1970 – 1986, 1988 – 1993	Donald Dreisbach 2003 – Present
P.A. Suter 1923 – 1933	William Cupp 1974 – 1976	G.W. Holden* 2003 – 2004
C.C. Wehly * 1923 – 1956	Robert R. Reese 1974 – 1986	Martin Terry 2003 – Present
L. Shirl Hatfield* 1934 - 1954	Russell Suter 1974 – 1984	James A. Downhower* 2004 - 2005
Peter Hilty 1934 – 1952	Daryl E. Amstutz 1977 – 1993	F. Alan Blackburn* 2005 –2007
Julian Kempf 1934 – 1952	Robert Rice 1980 – 1986	J. Peter Suter 2006 - Present
Wilmer D. Niswander* 1938 – 1955, 1958 – 1961	Paul Bixel 1985 – 1986, 1988 – 1995	John Arnold 2007- 2009
Clifford Pierman 1949 – 1955	Lois Rodabaugh 1985 – 1989	Todd A. Mason* 2007- Present
		Jared Lehman 2011 - Present
		Randal Verhoff 2013 - Present

*Designates CEO

We wish to express our appreciation to the late Mr. Lowell Hatfield for his assistance compiling the above list. We appreciate the many years of service he and his family contributed to The First National Bank of Pandora.

We welcome your additions and corrections so that we may properly recognize those who have served our company. Please contact Liz Gross at (419) 384-3221, Extension 1104.

