



2012

2012 annual report

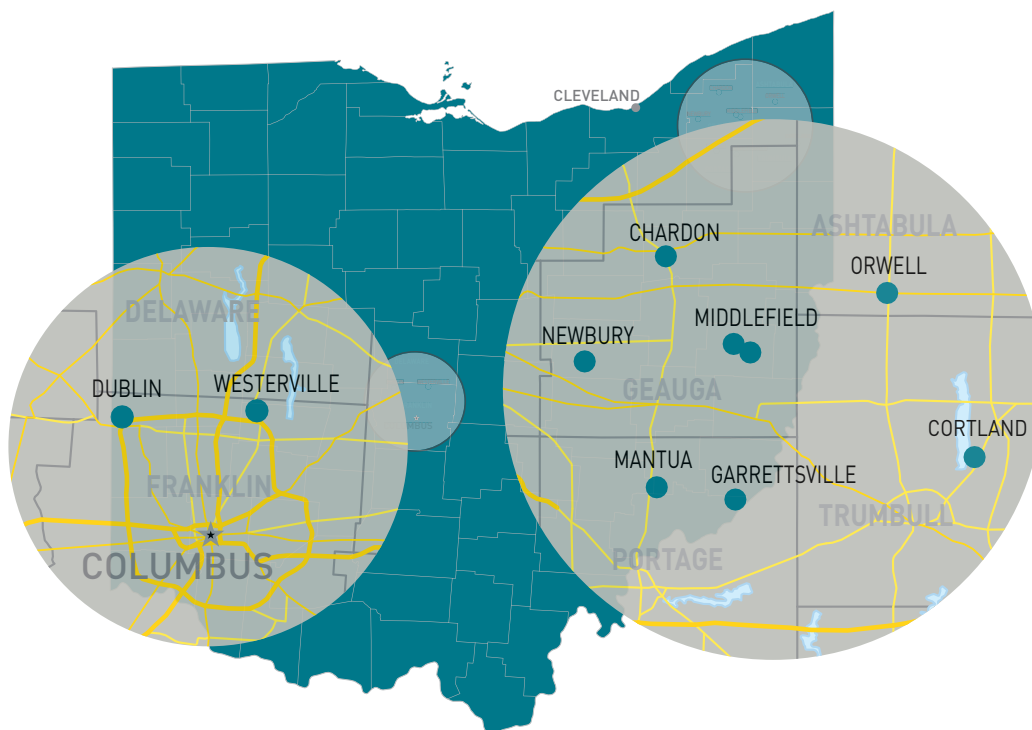
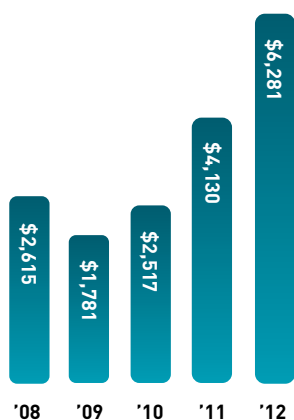


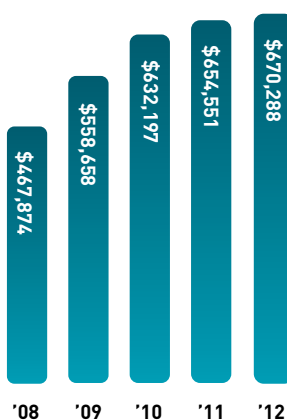
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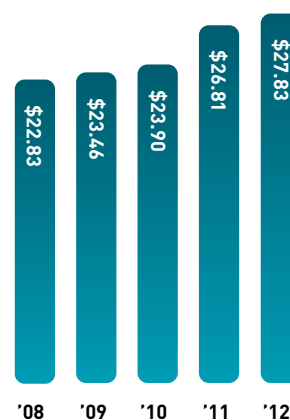
Statistical SUMMARY



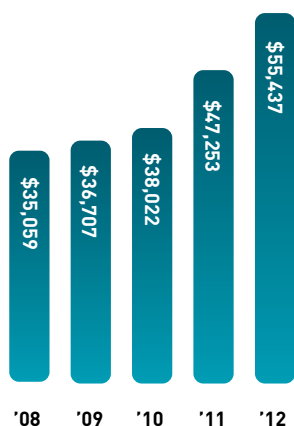
Net Income
(in thousands)



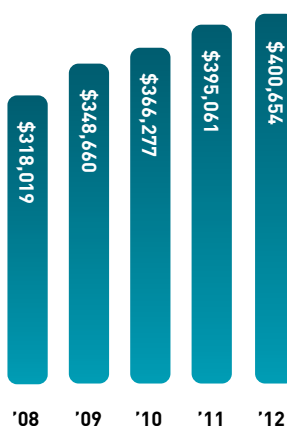
Total Assets
(in thousands)



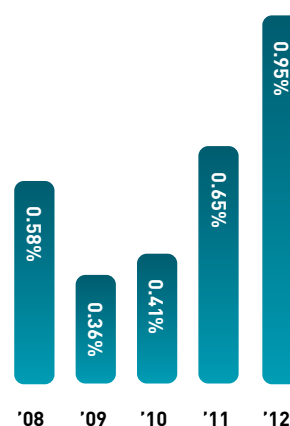
Book Value Per Share



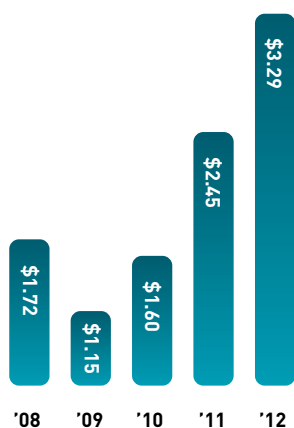
Equity Capital
(in thousands)



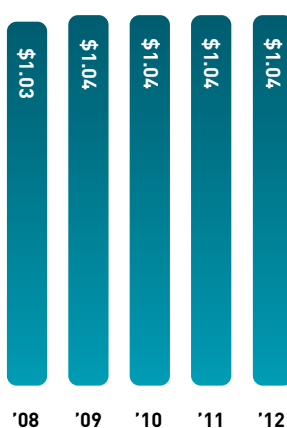
Net Loans Outstanding
(in thousands)



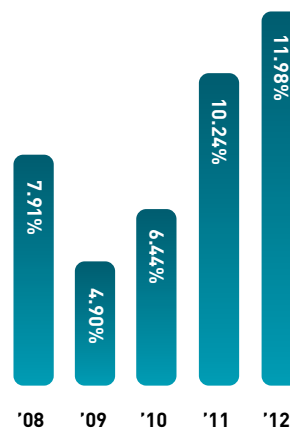
Return on Average Assets



Basic Earnings Per Share



Dividends Per Share



Return on Average Equity

Decade of PROGRESS

(Dollar amounts in thousands, except earnings per share data)	2003	2004	2005
Interest Income	\$ 14,647	\$ 15,733	\$ 17,379
Interest Expense	5,725	5,769	6,655
Net Interest Income	8,922	9,964	10,724
Provision for Loan Loss	315	174	302
Net Interest Income After Provision for Loan Losses	8,607	9,790	10,422
Noninterest Income, Including Security Gains/Losses	1,428	1,779	2,119
Noninterest Expense	6,105	6,966	7,425
Income Before Income Taxes	3,930	4,603	5,116
Income Taxes	1,131	1,330	1,415
Net Income	\$ 2,799	\$ 3,273	\$ 3,701
Total Assets	\$262,369	\$291,214	\$311,214
Deposits	219,840	239,885	249,450
Equity Capital	23,504	24,822	27,289
Loans Outstanding, Net	190,359	213,030	231,214
Allowance for Loan Losses	2,521	2,623	2,841
Net Charge-offs	94	72	84
Full Time Employees (Average Equivalents)	72	73	75
Number of Offices	6	6	6
Earnings Per Share	\$ 1.89	\$ 2.18	\$ 2.50
Dividends Per Share	0.65	0.72	0.80
Book Value Per Share	16.49	17.67	19.25
Dividend Payout Ratio	34.37%	32.72%	31.69%
Cash Dividends Paid	\$ 962	\$ 1,071	\$ 1,173
Return on Average Assets	1.13%	1.17%	1.23%
Return on Average Equity	12.39%	13.36%	14.43%

2006	2007	2008	2009	2010	2011	2012
\$ 19,494	\$ 24,873	\$ 26,038	\$ 26,051	\$ 29,094	\$ 29,727	\$ 28,746
8,567	13,531	14,058	11,783	10,945	8,652	6,447
10,927	11,342	11,980	14,268	18,149	21,075	22,299
60	430	608	2,578	3,580	3,085	2,168
10,867	10,912	11,372	11,690	14,569	17,990	20,131
2,427	2,632	2,226	2,668	2,623	2,237	3,451
7,938	9,373	10,596	12,650	14,763	15,501	15,639
5,356	4,171	3,002	1,708	2,429	4,726	7,943
1,472	796	387	(73)	(88)	596	1,662
\$ 3,884	\$ 3,375	\$ 2,615	\$ 1,781	\$ 2,517	\$ 4,130	\$ 6,281
\$340,604	\$434,273	\$467,847	\$558,658	\$632,197	\$654,551	\$670,288
271,050	362,918	394,819	487,106	565,251	580,962	593,335
30,464	34,962	35,059	36,707	38,022	47,253	55,437
246,342	306,147	318,019	348,660	366,277	395,061	400,654
2,849	3,299	3,557	4,937	6,221	6,819	7,779
52	423	351	1,198	2,296	2,487	1,208
80	91	101	106	108	113	120
8	9	10	10	10	10	10
\$ 2.60	\$ 2.17	\$ 1.72	\$ 1.15	\$ 1.60	\$ 2.45	\$ 3.29
0.87	0.94	1.03	1.04	1.04	1.04	1.04
20.30	22.56	22.83	23.46	23.90	26.81	27.83
33.43%	43.07%	60.25%	90.28%	65.04%	42.71%	31.87%
\$ 1,299	\$ 1,454	\$ 1,575	\$ 1,608	\$ 1,637	\$ 1,764	\$ 2,002
1.22%	0.85%	0.58%	0.36%	0.41%	0.65%	0.95%
13.59%	10.06%	7.91%	4.90%	6.44%	10.24%	11.98%

NOTE: The above per share amounts have been restated to 5% stock dividends paid in 2003, 2004, 2005, 2006 and 2007.

Letter to Our SHAREHOLDERS



Thomas G. Caldwell
President and Chief Executive Officer

To Our Shareholders and Friends:

On the following pages of this our report to you on the performance of your company, you will find the results of our focus to increase profitability while controlling growth. I am pleased to report that our efforts on these two fronts have been successful and trust that you will find the strength and stability of Middlefield Banc Corp. to be noteworthy.

For the second consecutive year, your company has achieved record earnings. Net income for 2012 was \$6.3 million, or \$3.28 per diluted share. This represents an increase of \$2.2 million, or 52%, from the 2011 net income of \$4.1 million. Continued strong performance in the level of net interest income, solid control of expenses, and enhanced non-interest income were all

drivers in our success. These factors were augmented by a reduction in our expense for provision on possible loan losses. This reduced level of allowance set aside was deemed prudent based upon improved asset quality.

Our efforts on controlling growth saw assets grow only \$15.7 million from year-end 2011, ending our most recent fiscal year at \$670.3 million. Net loans at December 31, 2012 were \$400.6 million, up \$5.6 million over the \$395.1 million reported at year-end 2011. As we ended 2012, total deposits were \$593.3 million, which was an increase of \$12.4 million from the \$581.0 million reported for December 31, 2011.

Like most within the industry, we did experience credit quality issues during the past few years of economic malaise. However, our net losses on loans for 2012 of \$1.2 million was down significantly from the \$2.5 million experienced the previous year. At year-end 2011, our total non-performing assets totaled \$26.7 million, or 4.09% of total assets. Over the course of 2012, this aggregate was reduced by 40% and finished the year at \$16.0 million, or 2.39% of total assets. Our allowance against future losses on loans stood at \$7.8 million as of December 31, 2012. The comparable figure at December 31, 2011 was \$6.8 million.

We were also pleased to provide a cash dividend of \$1.04 per share during 2012. Over the past five years, many of those within the financial services sector faced the prospects of their reduced earnings potential and cut dividends dramatically, including some to only one cent per share. Although we remained ever mindful of the need to balance growth, profitability, and shareholder return, our strong performance over this period permitted the opportunity to provide a fair return. In fact, during 2012, we returned in excess of \$2.0 million to our shareholders as cash dividend payments.

Looking ahead, we find that many of the concerns that we have written about over the last few years remain prevalent. The Federal Open Market Committee has committed to keeping interest rates at historic lows well into 2014. Even at that, this rate-setting body has stated that such a time horizon will serve only as a guideline and that low rates may continue well beyond. Quite obviously, this continued low rate scenario does nothing positive for those who are attempting to save. The next generation, therefore, is faced with being the first that will be less financially well-off than the preceding generation.

From a business of banking perspective, loan interest rates are being driven ever lower, both by public expectation and by competitive forces. A mediocre economy contributes to many lenders prospecting for solid loans among a smaller pool of truly creditworthy opportunities. With deposit costs already low, a shrinking universe of asset yield forces a compression of bank's net interest margin and, by act, a reduction in the net interest income level. Those within our industry are then forced to counteract those forces by charging higher fees for services provided or by reducing non-interest costs, perhaps at the prospect of reducing service levels.

Continuing to build upon this reality is the ever increasing burden of new and increased regulation. The Consumer Financial Protection Bureau continues to churn out new requirements that increase direct and indirect costs, while reducing efficiency and a satisfactory return to shareholders. The actual amount of increased cost of compliance is indeterminable at this point, but is exhibiting a very upward-sloped trend line.

As we approach 2013, even with the challenges already known, please accept our assurance that our seven Core Values remain at the center of all that we do. We firmly believe that these Values—*Customer Service, Honesty and Integrity, Efficiency, Team Focus, Community Commitment, Proactive Approach, and Commitment to Shareholders*—define and distinguish your company from those within our markets.

At the 2013 Annual Meeting of Shareholders, Richard T. Coyne will be retiring from the board of directors. The dean of our board, Dick has been a strong proponent of growth, return to shareholders, and commitment to our communities. We will miss his counsel and wish him only the very best on a well-deserved retirement.

We remain committed to serving as prudent stewards of our capital and recognize that we are charged with managing the same so as to maximize shareholder returns. Continued improvement in asset quality, sound assessment of our organization, and a firm attention to detail will contribute to these efforts.

Our commitment continues to be a strong community-based financial services company. The management team and staff of our banks have contributed to the strong performance that is reported herein. We are especially proud of their contributions.

In closing, on behalf of all affiliated with Middlefield Banc Corp., it is my privilege to thank you for your continued confidence and entrusting us with your investment.

Sincerely,



Thomas G. Caldwell
President and Chief Executive Officer

Letter from the CHAIRMAN



Richard T. Coyne
Chairman, Board of Directors

Chairman's Report to the Shareholders

Your bank is a leader in providing Personal, Business, and Online Banking and Investment services, and we plan to keep it that way!

Our operating subsidiaries, The Middlefield Banking Company and Emerald Bank, exceeded their net income goals. Our 2012 earnings were \$3.28 per share, a new Company record.

Over the years our employees have worked hard to establish solid relationships with our customers, and to add to and maintain a solid banking foundation of operational excellence.

The Middlefield Banking Company and Emerald Bank are well positioned in the communities we serve. We have upgraded our internet services so that we have the ability to provide a broad range of banking choices at competitive prices for our customers.

We continue to build on our significant success, which by design should continue to create shareholder value for you, our shareholders.

Middlefield Banc Corp. directors and officers thank you for your continued support.

Sincerely,

A handwritten signature in dark ink, reading "Richard T. Coyne". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Richard T. Coyne
Chairman, Board of Directors

Middlefield Banc Corp. BOARD OF DIRECTORS



Richard T. Coyne – 1997
Chairman, Board of Directors,
Middlefield Banc Corp.
The Middlefield Banking Company
Retired: Jaco Products and
Capital Plastics



William J. Skidmore – 2007
Northeast Ohio Senior
District Manager
Waste Management
of Ohio, Inc.



Thomas G. Caldwell – 1997
President and Chief Executive Officer
Middlefield Banc Corp.
The Middlefield Banking Company



Kenneth E. Jones – 2008
President
Chesapeake Financial Advisors
Chairman, Board of Directors
Emerald Bank



James R. Heslop, II – 2001
Executive Vice President
Chief Operating Officer
Middlefield Banc Corp.
The Middlefield Banking Company



Robert W. Toth – 2009
Retired: Gold Key Processing, Ltd



James J. McCaskey – 2004
President
McCaskey Landscape and Design,
LLC



Eric W. Hummel – 2011
President
Hummel Construction



Carolyn J. Turk, C.P.A. – 2004
Controller
Molded Fiber Glass Companies



Darryl E. Mast* – 2011
Vice President, Operations
Hattie Larlham



Emerald
B A N K

EMERALD BANK DIRECTORS & OFFICERS

Board of Directors

Kenneth E. Jones – 2004

*Chairman, Board of Directors, Emerald Bank
President
Chesapeake Financial Advisors*

George J. Kontogiannis, AIA – 2004

*Chief Executive Officer
The Kontogiannis Companies*

Joseph C. Zanetos – 2004

*President
Anthony-Thomas Candy Co.*

Clayton W. Rose, III, C.P.A. – 2006

*Shareholder
Rea & Associates, Inc.*

Thomas G. Caldwell – 2007

*President and Chief Executive Officer
Middlefield Banc Corp.
The Middlefield Banking Company*

Richard T. Coyne – 2007

*Chairman, Board of Directors, Middlefield Banc Corp.
The Middlefield Banking Company
Retired: Jaco Products and Capital Plastics*

James L. Long – 2008

*President and Chief Executive Officer
Emerald Bank*

Officers

James L. Long – 2008

President and Chief Executive Officer

Donald L. Stacy – 2007

Chief Financial Officer and Treasurer

Joe T. Glassco – 2009

*Vice President
Commercial Lender*

Charles T. Woodson – 2008

*Assistant Vice President
Westerville Branch Manager*

Laura E. Neale – 2010

*Assistant Vice President
Commercial Lender*

Barbara J. Howard – 2004

*Administrative Officer
Accounting*

Megan E. Davie – 2010

*Corporate Secretary and Administrative Officer
Branch Supervisor*

Melody A. Askey – 2009

Compliance Officer

EMERALD BANK STAFF & BRANCH LOCATIONS



DUBLIN BRANCH *Drive up ATM*

6215 Perimeter Drive
Dublin, Ohio 43017
614.793.4631 • fax: 614.793.8922

STAFF:

Elaine Gaub – 2005 – *Customer Services*

Colleen Pirrmann – 2011 – *Loan Ops Specialist*

Valerija Kapetanovic – 2012 – *Customer Services*



WESTERVILLE BRANCH *Drive up ATM*

17 North State Street
Westerville, Ohio 43081
614.890.7832 • fax: 614.890.4633

STAFF:

Elizabeth Stolz – 2012 – *Teller Supervisor*

Valorie Thorpe – 2010 – *Customer Services*

Jason Nelson – 2011 – *Customer Services*

Jana Daugherty – 2012 – *Customer Services*



THE MIDDLEFIELD BANKING COMPANY OFFICERS

Thomas G. Caldwell – 1986

President and Chief Executive Officer

James R. Heslop, II – 1996

Executive Vice President

Chief Operating Officer

Teresa M. Hetrick – 1996

Senior Vice President

Operations/Administration

Jay P. Giles – 1998

Senior Vice President

Senior Lender

Donald L. Stacy – 1999

Senior Vice President

Chief Financial Officer

Dennis E. Linville – 2006

Senior Vice President

Area Executive

Kathleen M. Johnson – 1971

Vice President

Chief Accounting Officer

Joann V. Vance – 1986

Vice President

Human Resource Administrator

Alfred F. Thompson, Jr. – 1996

Vice President

Loan Administration

Sharon R. Jarold – 2001

Vice President

Commercial Lender

Matthew E. Bellin – 2006

Vice President

Commercial Lender

Felicia M. Hough – 2009

Vice President

Regional Branch Administration

Courtney M. Erminio – 2010

Vice President

Risk Officer

Karen D. Branham – 1983

Assistant Vice President

Bookkeeping Manager

Thomas R. Neikirk – 1994

Assistant Vice President

West Branch Manager

Marlin J. Moschell – 2000

Assistant Vice President

Orwell Lending Officer

Kevin J. Mitchell – 2007

Assistant Vice President

Orwell Branch Manager

Dale L. Moore – 2009

Assistant Vice President

IT Administrator

James C. Foster – 2011

Assistant Vice President

Lender II

Kathleen M. Vanek – 1998

Banking Officer

Mantua Branch Manager

Brian J. Martinko – 2006

Banking Officer

Lender

Jean M. Carter – 2009

Banking Officer

Chardon Branch Manager

Lisabeth A. Muldowney – 2012

Banking Officer

Cortland Branch Manager

Melody A. Askey – 2005

Compliance/CRA Officer

THE MIDDLEFIELD BANKING COMPANY STAFF & BRANCH LOCATIONS



STAFF:

Mary Gerbasi – 2010 – *Branch Manager*
Louise Fenselon – 1984 – *Head Teller*
Diana Koller – 1998 – *Teller*
Kristina Stephens – 2006 – *CSR/Licensed Annuity Specialist*
Linda Chandler – 2007 – *Teller*
Melissa Gay – 2008 – *Customer Service Representative*
Rachel DeYoung – 2010 – *Teller*
Jean Maur – 2010 – *Teller*
Stacey Albright – 2011 – *Receptionist*
Erica Brilla – 2012 – *Teller**
Brent Hyde – 2012 – *Teller**

FINANCIAL SERVICES:

Thomas Hart – 2004 – *Financial Consultant*

MAIN OFFICE *Walk up ATM*

15985 East High Street, P.O. Box 35
Middlefield, Ohio 44062
888.801.1666 • 440.632.1666 • fax: 440.632.1700

LENDING DEPARTMENT:

Jane Armstrong – 1998 – *Lender*
Amanda Howes – 2006 – *Commercial Loan Administrator**
Bethany Rowland – 2008 – *Commercial Loan Administrator*

LOAN ADMINISTRATION:

Helen Stowe – 1985 – *Loan Operations Assistant*
Vivian Helmick – 1998 – *Loan Operations Assistant*
Carolyn Fackler – 2001 – *Loan Documentation Assistant*
Sue Trumbull – 2005 – *Loan Documentation Assistant*
Darleen Beaver – 2007 – *Loan Receptionist & Documentation Assistant*
Linda Hammel – 2008 – *Loan Collection Manager*
Terry Lehmann – 2009 – *Credit Analyst*
J. Thomas Browne – 2010 – *Credit Analyst*
Carmella Honkala – 2010 – *Loan Documentation Assistant*
Michael Morrison – 2010 – *Special Assets Manager*
Brett Richey – 2010 – *Special Assets Manager*
Mark Sawyer – 2010 – *Loan Department Supervisor*
Cheryl Decavitch – 2012 – *Loan Documentation Assistant*
Alex Duff – 2012 – *Junior Credit Analyst*
Jeff Rinearson – 2012 – *Loan Documentation Assistant*



CHARDON BRANCH *Drive up ATM*

348 Center Street, P.O. Box 1078
Chardon, Ohio 44024
888.801.1666 • 440.286.1222 • fax: 440.286.1111

STAFF:

Beverly Palinsky – 2005 – *Teller**
Dottie Brown – 2006 – *Head Teller*
Amy Murfello – 2006 – *Customer Service Representative*
Kim Hess – 2011 – *Teller*
Kathleen Ammon – 2012 – *Teller**

* denotes part time

STAFF:

Patti Russo – 1982 – *CSR/Licensed Annuity Specialist*
Rachel Lilly – 1985 – *Head Teller*
Rachel Reese – 2005 – *Teller**
Brenda Bowden – 2008 – *Teller*
Melissa Mathews – 2009 – *Teller*
Heather Eiermann – 2011 – *Teller**
Nancy McCullough – 2011 – *Teller*
Tami Butto – 2012 – *Teller**
Katelyn Hanzel – 2012 – *Teller**

OPERATIONS:

Karen Westover – 1983 – *Bookkeeper*
Pamela Malcuit – 1989 – *Bookkeeper*
Donna Williams – 1990 – *Bookkeeper*
Lauren Harth – 1995 – *Audit Assistant**
Tara Morgan – 1997 – *Proof Specialist*
Bonnie Hofstetter – 1998 – *Courier**
Lisa Sanborn – 2000 – *Electronic Banking Specialist*
Joan Sweet – 2002 – *Bookkeeper*
Marcia Dziczkowski – 2008 – *Bookkeeper*
David Harth – 2008 – *Facility Manager*
Sherry Krok – 2008 – *Bookkeeper*
Carrie Reiter – 2008 – *Courier**
Donna Marcello – 2009 – *Float Teller*
Sean Gerin – 2011 – *HR Assistant*
Derreck Haynes – 2011 – *IS Support Representative*
Michael Ranttila – 2011 – *Accounting Specialist*
Stephanie Armstrong – 2012 – *Compliance Assistant*
Patricia Kelley – 2012 – *Float Teller*
Alyssa Warren – 2012 – *Float Teller*
Yvette Zemelka – 2012 – *Float Teller*

**GARRETTSVILLE BRANCH** *Drive up ATM*

8058 State Street
 Garrettsville, Ohio 44231
 888.801.1666 • 330.527.2121 • fax: 330.527.4210

STAFF:

Gretchen Cram – 2008 – *Branch Manager*
Vickie Moss – 1998 – *Teller*
Colleen Steele – 1998 – *Head Teller*
Dawn Semich – 2005 – *CSR/Licensed Annuity Specialist*
LynnRae Derthick – 2006 – *Teller*
Betty Lesho – 2011 – *Teller*
Lisa Morrison – 2012 – *Teller**
Linda Stacy – 2012 – *Teller**

* denotes part time



THE MIDDLEFIELD BANKING COMPANY STAFF & BRANCH LOCATIONS



ORWELL BRANCH *Drive up ATM*
30 South Maple Street, P.O. Box 66
Orwell, Ohio 44076
888.801.1666 • 440.437.7200 • fax: 440.437.1111

STAFF:

Jessica Slusher – 2006 – *Teller**
Lisa Swango – 2006 – *CSR/Licensed Annuity Specialist*
Denise Smith – 2009 – *Teller*
Sue Haehn – 2010 – *Teller**
Malinda Miller – 2012 – *Teller**
Lisa Stokes – 2012 – *Teller*



CORTLAND BRANCH *Drive up ATM*
3450 Niles-Cortland Road
Cortland, Ohio 44410
888.801.1666 • 330.637.3208 • fax: 330.637.3207

STAFF:

Jeanette Meardith – 2006 – *Head Teller*
Shannon Smith – 2009 – *Teller*
Tami Davenport – 2010 – *Teller**
Angie Lewis – 2010 – *Customer Service Representative*
Juliann Kish – 2012 – *Teller*



MANTUA BRANCH *Walk up ATM*
10519 Main Street, P.O. Box 648
Mantua, Ohio 44255
888.801.1666 • 330.274.0881 • fax: 330.274.0883

STAFF:

Jodie Lawless – 2004 – *Customer Service Representative*
Katelyn Cook – 2012 – *Teller**
Nicole Lange – 2012 – *Teller**



NEWBURY BRANCH *Drive up ATM*
11110 Kinsman Road, Suite 1, P.O. Box 208
Newbury, Ohio 44065
888.801.1666 • 440.564.7000 • fax: 440.564.7004

STAFF:

Kathy Shanholtzer – 2007 – *Branch Manager*
Diane Thomas – 2006 – *Teller**
Helen Milburn – 2008 – *Customer Service Representative*
Christopher Franklin – 2011 – *Teller*
Elizabeth Brower – 2012 – *Teller**

* denotes part time

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of
1934 for the fiscal year ended: December 31, 2012

Commission File Number: 000-32561

Middlefield Banc Corp.

(Exact name of registrant as specified in its charter)

Ohio

(State or other jurisdiction of
incorporation or organization)

34-1585111

(IRS Employer
Identification No.)



15985 East High Street, Middlefield, Ohio 44062-0035
(440) 632-1666

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Securities registered pursuant to section 12(b) of the Act : none

Securities registered pursuant to section 12(g) of the Act : common stock, without par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes ☐ No ☒

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☒

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

The aggregate market value on June 30, 2012 of common stock held by non-affiliates of the registrant was approximately \$44.6 million. As of March 12, 2013, there were 2,011,035 shares of common stock issued and outstanding.

Documents Incorporated by Reference Portions of the registrant's definitive proxy statements for the 2013 Annual Meeting of Shareholders are incorporated by reference in Part III of this report. Portions of the Annual Report to Shareholders for the year ended December 31, 2012 are incorporated by reference into Part I and Part II of this report.

MIDDLEFIELD BANC CORP.
YEAR ENDED DECEMBER 31, 2012
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SIGNATURES

Item 1 — Business

Middlefield Banc Corp Incorporated in 1988 under the Ohio General Corporation Law, Middlefield Banc Corp. (“Company”) is a two-bank and a one non-bank holding company registered under the Bank Holding Company Act of 1956. The Company’s three subsidiaries are:

1. The Middlefield Banking Company (“MBC”), an Ohio-chartered commercial bank that began operations in 1901. MBC engages in a general commercial banking business in northeastern Ohio. The principal executive office is located at 15985 East High Street, Middlefield, Ohio 44062-0035, and its telephone number is (440) 632-1666.
2. Emerald Bank (“EB”), an Ohio-chartered commercial bank headquartered in Dublin, Ohio. EB engages in a general commercial banking business in central Ohio. The principal executive office is located at 6215 Perimeter Drive, Dublin Ohio 43017, and its telephone number is (614) 793-4631.
3. EMORECO Inc., an Ohio asset resolution corporation headquartered in Middlefield, Ohio. EMORECO engages in the resolution and disposition of troubled assets in central Ohio. The principal executive office is located at 15985 East High Street, Middlefield, Ohio 44062-0035, and its telephone number is (440) 632-1666.

The Middlefield Banking Company MBC was chartered under Ohio law in 1901. The Company became the holding company for MBC in 1988. MBC offers its customers a broad range of banking services, including checking, savings, and negotiable order of withdrawal (NOW) accounts, money market accounts, time certificates of deposit, commercial loans, real estate loans, and various types of consumer loans, safe deposit facilities, and travelers’ checks. MBC offers online banking and bill payment services to individuals and online cash management services to business customers through its website at www.middlefieldbank.com.

Engaged in a general commercial banking business in northeastern Ohio, MBC offers commercial banking services principally to small and medium-sized businesses, professionals, small business owners, and retail customers. MBC has developed and continues to monitor and update a marketing program to attract and retain consumer accounts, and to offer banking services and facilities compatible with the needs of its customers.

MBC’s loan products include operational and working capital loans, loans to finance capital purchases, term business loans, residential construction loans, selected guaranteed or subsidized loan programs for small businesses, professional loans, residential mortgage and commercial mortgage loans, and consumer installment loans to purchase automobiles, boats, and for home improvement and other personal expenditures. Although the bank makes agricultural loans, it currently has no significant agricultural loans.

Emerald Bank The Company acquired EB on April 19, 2007 for a combination of cash and stock. EB operates as a separate commercial bank subsidiary of the Company, offering essentially the same range of products and services in central Ohio as MBC does in northeastern Ohio.

EMORECO Organized in 2009 as an Ohio corporation under the name EMORECO, Inc. and wholly owned by the Company, the purpose of the asset resolution subsidiary is to maintain, manage, and ultimately dispose of nonperforming loans and other real estate owned (“OREO”) acquired by subsidiary banks as the result of borrower default on real-estate-secured loans. At December 31, 2012, EMORECO’s assets consist of six nonperforming loans and eight OREO properties. EMORECO has paid approximately \$5.8 million to Emerald Bank for the nonperforming loans and OREO, using funds contributed by the Company, which were borrowed under lines of credit of the Company. According to Federal law governing bank holding companies the real estate must be disposed of within two years after the properties were originally acquired by EB, which occurred in May and June of 2008, although limited extensions may be granted by the Federal Reserve Bank. Federal law governing bank holding companies also provides that a holding company subsidiary has limited real estate investment powers. EMORECO may only manage and maintain property and may not improve or develop property without advance approval of the Federal Reserve Bank.

Market Area MBC’s market area consists principally of Geauga, Portage, Trumbull, and Ashtabula Counties. Benefitting from the area’s proximity to Cleveland and Warren, population and income levels have maintained steady growth over the years. EB’s two branches are located in Franklin County, serving the central Ohio market.

Competition The banking industry has been changing for many reasons, including continued consolidation within the banking industry, legislative and regulatory changes, and advances in technology. To deliver banking products and services more effectively and efficiently, banking institutions are opening in-store branches, installing more automated teller machines (ATMs) and investing in technology to permit telephone, personal computer, and internet banking. While all banks are experiencing the effects of the changing competitive and technological environment, the manner in which banks choose to compete is increasing the gap between large national and super-regional banks, on one hand, and community banks on the other. Large institutions are committed to becoming national or regional “brand names,” providing a broad selection of products at low cost and with advanced technology, while community banks provide most of the same products but with a commitment to personal service and with local ties to the customers and communities they serve. The Company seeks to take competitive advantage of its local orientation and community banking profile. It competes for loans principally through responsiveness to customers and its ability to communicate effectively with them and understand and address their needs. The Company competes for deposits principally by offering customers personal attention, a variety of banking services, attractive rates, and strategically located banking facilities. The Company seeks to provide high quality banking service to professionals and small and mid-sized businesses, as well as individuals, emphasizing quick and flexible responses to customer demands.

Forward-looking Statements This document contains forward-looking statements (as defined in the Private Securities Litigation Reform Act of 1995) about the Company and subsidiaries. Information incorporated in this document by reference, future filings by the Company on Form 10-Q and Form 8-K, and future oral and written statements by the Company and its management may also contain forward-looking statements. Forward-looking statements include statements about anticipated operating and financial performance, such as loan originations, operating efficiencies, loan sales, charge-offs and loan loss provisions, growth opportunities, interest rates, and deposit growth. Words such as “may,” “could,” “should,” “would,” “believe,” “anticipate,” “estimate,” “expect,” “intend,” “project,” “plan,” and similar expressions are intended to identify these forward-looking statements.

Forward-looking statements are necessarily subject to many risks and uncertainties. A number of things could cause actual results to differ materially from those indicated by the forward-looking statements. These include the factors we discuss immediately below, those addressed under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” other factors discussed elsewhere in this document or identified in our filings with the Securities and Exchange Commission, and those presented elsewhere by our management from time to time. Many of the risks and uncertainties are beyond our control. The following factors could cause our operating and financial performance to differ materially from the plans, objectives, assumptions, expectations, estimates, and intentions expressed in forward-looking statements:

- the strength of the United States economy in general and the strength of the local economies in which we conduct our operations; general economic conditions, either nationally or regionally, may be less favorable than we expect, resulting in a deterioration in the credit quality of our loan assets, among other things
- the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest-rate policies of the Federal Reserve Board
- inflation, interest rate, market, and monetary fluctuations
- the development and acceptance of new products and services of the Company and subsidiaries and the perceived overall value of these products and services by users, including the features, pricing, and quality compared to competitors’ products and services
- the willingness of users to substitute our products and services for those of competitors
- the impact of changes in financial services laws and regulations (including laws concerning taxes, banking, securities, and insurance)
- changes in consumer spending and saving habits

Forward-looking statements are based on our beliefs, plans, objectives, goals, assumptions, expectations, estimates, and intentions as of the date the statements are made. Investors should exercise caution because the Company cannot give any assurance that its beliefs, plans, objectives, goals, assumptions, expectations, estimates, and intentions will be realized. The Company disclaims any obligation to update or revise any forward-looking statements based on the occurrence of future events, the receipt of new information, or otherwise.

Lending — *Loan Portfolio Composition and Activity.* The Company makes residential mortgage and commercial mortgage loans, home equity loans, secured and unsecured consumer installment loans, commercial and industrial loans, and real estate construction loans for owner-occupied and rental properties. The Company's loan policy aspires to a loan composition mix consisting of approximately 40% to 50% residential real estate loans, 35% to 40% commercial loans, consumer loans of 5% to 15%, and credit card accounts of up to 5%. The lending policies of MBC and EB are essentially identical.

Although Ohio Bank law imposes no material restrictions on the kinds of loans the Company may make, real estate-based lending has historically been the Banks' primary focus. For prudential reasons, the Banks avoid lending on the security of real estate located in regions in which the Bank is not familiar, and as a consequence almost all of the MBC's real-estate secured loans are secured by real property in northeastern Ohio. EB's lending is also predominantly real-estate secured lending. EB's lending currently is concentrated in its Central Ohio market area, although previously EB had extended a number of real-estate secured loans in the southwestern Ohio market. Ohio Bank law does restrict the amount of loans an Ohio-chartered bank such as the Banks may make, however, generally providing that loans and extensions of credit to any single borrower may not exceed 15% of capital. An additional margin of 10% of capital is allowed for loans fully secured by readily marketable collateral. This 15% legal lending limit has not been a material restriction on the Banks' lending. The Banks can accommodate loan volumes exceeding the legal lending limit by selling loan participations to other banks. MBC's and EB's internal policy is to maintain its credit exposure to any one borrower at less than \$3.0 million and \$1.2 million, respectively, which is comfortably within the range of the Banks' legal lending limit. As of December 31, 2012, MBC's 15%-of-capital limit on loans to a single borrower was approximately \$7.5 million and EB's 15%-of-capital limit on loans to a single borrower was approximately \$1.5 million.

The Company offers specialized loans for business and commercial customers, including equipment and inventory financing, real estate construction loans and Small Business Administration loans for qualified businesses. A substantial portion of the Banks' commercial loans are designated as real estate loans for regulatory reporting purposes because they are secured by mortgages on real property. Loans of that type may be made for purpose of financing commercial activities, such as accounts receivable, equipment purchases and leasing, but they are secured by real estate to provide the Bank with an extra measure of security. Although these loans might be secured in whole or in part by real estate, they are treated in the discussions to follow as commercial and industrial loans. The Company's consumer installment loans include secured and unsecured loans to individual borrowers for a variety of purposes, including personal, home improvements, revolving credit lines, autos, boats, and recreational vehicles.

The following table shows on a consolidated basis the composition of the loan portfolio in dollar amounts and in percentages along with a reconciliation to loans receivable, net.

Loan Portfolio Composition at December 31,										
	2012		2011		2010		2009		2008	
(Dollars in thousands)	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Type of loan:										
Commercial and industrial	\$ 62,188	15.23%	\$ 59,185	14.73%	\$ 57,501	15.44%	\$ 56,969	16.11%	\$ 66,524	20.69%
Real estate construction	22,522	5.51	21,545	5.36	15,845	4.25	7,837	2.22	7,965	2.48
Mortgage:										
Residential	203,872	49.92	208,139	51.79	209,863	56.34	205,074	58.00	199,354	61.99
Commercial	115,734	28.34	108,502	27.00	84,304	22.63	78,763	22.27	42,789	13.31
Consumer installment	4,117	1.00	4,509	1.12	4,985	1.34	4,954	1.40	4,943	1.53
Total loans	408,433	100.00%	401,880	100.00%	372,498	100.00%	353,597	100.00%	321,575	100.00%
Less:										
Allowance for loan losses	7,779		6,819		6,221		4,937		3,557	
Net loans	<u>\$400,654</u>		<u>\$395,061</u>		<u>\$366,277</u>		<u>\$348,660</u>		<u>\$318,018</u>	

The following table presents consolidated maturity information for the loan portfolio. The table does not include prepayments or scheduled principal repayments. All loans are shown as maturing based on contractual maturities.

Loan Portfolio Maturity at December 31, 2012						
(Dollars in thousands)	Commercial and Industrial	Real Estate Construction	Mortgage		Consumer Installment	Total
			Residential	Commercial		
Amount due:						
In one year or less	\$ 12,059	\$ 4,378	\$ 3,562	\$ 4,609	\$ 229	\$ 24,837
After one year through five years	19,503	611	16,006	3,498	3,517	43,135
After five years	30,626	17,533	184,304	107,627	371	340,461
Total amount due	<u>\$ 62,188</u>	<u>\$ 22,522</u>	<u>\$ 203,872</u>	<u>\$ 115,734</u>	<u>\$ 4,117</u>	<u>\$ 408,433</u>

Loans due on demand and overdrafts are included in the amount due in one year or less. The Company has no loans without a stated schedule of repayment or a stated maturity.

The following table shows on a consolidated basis the dollar amount of all loans due after December 31, 2012 that have pre-determined interest rates and the dollar amount of all loans due after December 31, 2012 that have floating or adjustable rates.

	Fixed Rate	Adjustable Rate	Total
(Dollars in thousands)			
Commercial and industrial	\$ 24,424	\$ 37,764	\$ 62,188
Real estate construction	5,837	16,685	22,522
Mortgage:			
Residential	18,197	185,675	203,872
Commercial	7,777	107,957	115,734
Consumer installment	4,043	74	4,117
	<u>\$ 60,278</u>	<u>\$ 348,155</u>	<u>\$ 408,433</u>

Residential Mortgage Loans A significant portion of the Company's lending consists of origination of conventional loans secured by 1-4 family real estate located in Franklin, Geauga, Portage, Trumbull, and Ashtabula Counties. Residential mortgage loans approximated \$203.9 million or 49.9% of the Company's total loan portfolio at December 31, 2012.

The Company makes loans of up to 80% of the value of the real estate and improvements securing a loan (the "loan-to-value" or "LTV" ratio) on 1-4 family real estate. The Company generally does not lend in excess of 80% of the appraised value or sales price (whichever is less) of the property unless additional collateral is obtained, thereby lowering the total LTV. The Company offers residential real estate loans with terms of up to 30 years.

Before 1996, nearly all residential mortgage loans originated by MBC were written on a balloon-note basis. During 1996, the Company began to originate fixed-rate mortgage loans for maturities up to 20 years. In late 1998, MBC began originating adjustable-rate mortgage loans and de-emphasized balloon-note mortgages. Approximately 90.7% of the portfolio of conventional mortgage loans secured by 1-4 family real estate at December 31, 2012 was adjustable rate. The Company's mortgage loans are ordinarily retained in the loan portfolio. The Company's residential mortgage loans have not been originated with loan documentation that would permit their sale to Fannie Mae and Freddie Mac.

The Company's home equity loan policy generally allows for a loan of up to 85% of a property's appraised value, less the principal balance of the outstanding first mortgage loan. The Company's home equity loans generally have terms of 10 years.

At December 31, 2012, residential mortgage loans of approximately \$8.5 million were over 90 days delinquent or non-accruing on that date, representing 4.2% of the residential mortgage loan portfolio. At December 31, 2011, residential mortgage loans of approximately \$10.9 million were over 90 days delinquent or non-accruing on that date, representing 5.2% of the residential mortgage loan portfolio.

Commercial and Industrial Loans and Commercial Real Estate Loans The Company's commercial loan services include —

- accounts receivable, inventory and working capital loans
- renewable operating lines of credit
- loans to finance capital equipment
- term business loans
- short-term notes
- selected guaranteed or subsidized loan programs for small businesses
- loans to professionals
- commercial real estate loans

Commercial real estate loans include commercial properties occupied by the proprietor of the business conducted on the premises, and income-producing or farm properties. Although the Company makes agricultural loans, it currently does not have a significant amount of agricultural loans. The primary risk of commercial real estate loans is loss of income of the owner or occupier of the property and the inability of the market to sustain rent levels. Although commercial and commercial real estate loans generally bear more risk than single-family residential mortgage loans, commercial and commercial real estate loans tend to be higher yielding, tend to have shorter terms and commonly provide for interest-rate adjustments as prevailing rates change. Accordingly, commercial and commercial real estate

loans enhance a lender's interest rate risk management and, in management's opinion, promote more rapid asset and income growth than a loan portfolio comprised strictly of residential real estate mortgage loans.

Although a risk of nonpayment exists for all loans, certain specific types of risks are associated with various kinds of loans. One of the primary risks associated with commercial loans is the possibility that the commercial borrower will not generate income sufficient to repay the loan. The Company's loan policy provides that commercial loan applications must be supported by documentation indicating that there will be cash flow sufficient for the borrower to service the proposed loan. Financial statements or tax returns for at least three years must be submitted, and annual reviews are undertaken for loans of \$150,000 or more. The fair market value of collateral for collateralized commercial loans must exceed the Company's loan exposure. For this purpose fair market value is determined by independent appraisal or by the loan officer's estimate employing guidelines established by the loan policy. Term loans not secured by real estate generally have terms of five years or less, unless guaranteed by the U.S. Small Business Administration or other governmental agency, and terms loans secured by collateral having a useful life exceeding five years may have longer terms. The Company's loan policy allows for terms of up to 15 years for loans secured by commercial real estate, and one year for business lines of credit. The maximum loan-to-value ratio for commercial real estate loans is 75% of the appraised value or cost, whichever is less.

Real estate is commonly a material component of collateral for the Company's loans, including commercial loans. Although the expected source of repayment of these loans is generally the operations of the borrower's business or personal income, real estate collateral provides an additional measure of security. Risks associated with loans secured by real estate include fluctuating land values, changing local economic conditions, changes in tax policies, and a concentration of loans within a limited geographic area.

At December 31, 2012, commercial and commercial real estate loans totaled \$177.9 million, or 43.6% of the Company's total loan portfolio. At December 31, 2012, commercial and commercial real estate loans of approximately \$3.4 million were over 90 days delinquent or non-accruing on that date, and represented 1.9% of the commercial and commercial real estate loan portfolios. At December 31, 2011, commercial and commercial real estate loans totaled \$167.7 million, or 41.7% of the Company's total loan portfolio. At December 31, 2011, commercial and commercial real estate loans of approximately \$5.5 million were over 90 days delinquent or non-accruing on that date, and represented 3.4% of the commercial and commercial real estate loan portfolios.

Real Estate Construction The Company originates several different types of loans that it categorizes as construction loans, including —

- residential construction loans to borrowers who will occupy the premises upon completion of construction,
- residential construction loans to builders,
- commercial construction loans, and
- real estate acquisition and development loans.

Because of the complex nature of construction lending, these loans are generally recognized as having a higher degree of risk than other forms of real estate lending. The Company's fixed-rate and adjustable-rate construction loans do not provide for the same interest rate terms on the construction loan and on the permanent mortgage loan that follows completion of the construction phase of the loan. It is the norm for the Company to make residential construction loans without an existing written commitment for permanent financing. The Company's loan policy provides that the Company may make construction loans with terms of up to one year, with a maximum loan-to-value ratio for residential construction of 80%.

At December 31, 2012, real estate construction loans totaled \$22.5 million, or 5.5% of the Company's total loan portfolio. Real estate construction loans of approximately \$364,000 were over 90 days delinquent or non-accruing on that date, representing 1.6% of the real estate construction loan portfolio. At December 31, 2011, real estate construction loans totaled \$21.6 million, or 5.4% of the Company's total loan portfolio. Real estate construction loans of approximately \$663,000 were over 90 days delinquent or non-accruing on that date, representing 3.2% of the real estate construction loan portfolio.

Consumer Installment Loans The Company's consumer installment loans include secured and unsecured loans to individual borrowers for a variety of purposes, including personal, home improvement, revolving credit lines, autos, boats, and recreational vehicles. The Company does not currently do any indirect lending. Unsecured consumer loans carry significantly higher interest rates than secured loans. The Company maintains a higher loan loss allowance for consumer loans, while maintaining strict credit guidelines when considering consumer loan applications.

According to the Company's loan policy, consumer loans secured by collateral other than real estate generally may have terms of up to five years, and unsecured consumer loans may have terms up to two and one-half years. Real estate security generally is required for consumer loans having terms exceeding five years.

At December 31, 2012, the Company had approximately \$4.1 million in its consumer installment loan portfolio, representing 1.0% of total loans. At December 31, 2012, consumer installment loans of approximately \$18,000 were over 90 days delinquent or non-accruing on that date, representing .4% of the consumer installment loan portfolio. At December 31, 2011, the Company had approximately \$4.5 million in its consumer installment loan portfolio, representing 1.1% of total loans. At December 31, 2011, no consumer installment loans were over 90 days delinquent or non-accruing.

Loan Solicitation and Processing Loan originations are developed from a number of sources, including continuing business with depositors, other borrowers and real estate builders, solicitations by Company personnel and walk-in customers.

When a loan request is made, the Company reviews the application, credit bureau reports, property appraisals or evaluations, financial information, verifications of income, and other documentation concerning the creditworthiness of the borrower, as applicable to each loan type. The Company's underwriting guidelines are set by senior management and approved by the Board of Directors. The loan policy specifies each individual officer's loan approval authority. Loans exceeding an individual officer's approval authority are submitted to a committee consisting of loan officers, which has authority to approve loans up to \$500,000. The full Board of Directors acts as a loan committee for loans exceeding that amount.

Income from Lending Activities The Company earns interest and fee income from its lending activities. Net of origination costs, loan origination fees are amortized over the life of a loan. The Company also receives loan fees related to existing loans, including late charges. Income from loan origination and commitment fees and discounts varies with the volume and type of loans and commitments made and with competitive and economic conditions. Note 1 to the Consolidated Financial Statements included herein contains a discussion of the manner in which loan fees and income are recognized for financial reporting purposes.

Nonperforming Loans Late charges on residential mortgages and consumer loans are assessed if a payment is not received by the due date plus a grace period. When an advanced stage of delinquency appears on a single-family loan and if repayment cannot be expected within a reasonable time or a repayment agreement is not entered into, a required notice of foreclosure or repossession proceedings may be prepared by the Company's attorney and delivered to the borrower so that foreclosure proceedings may be initiated promptly, if necessary. The Company also collects late charges on commercial loans.

When the Company acquires real estate through foreclosure, voluntary deed, or similar means, it is classified as OREO until it is sold. When property is acquired in this manner, it is recorded at the lower of cost (the unpaid principal balance at the date of acquisition) or fair value. Any subsequent write-down is charged to expense. All costs incurred from the date of acquisition to maintain the property are expensed. OREO is appraised during the foreclosure process, before acquisition. Losses are recognized for the amount by which the book value of the related mortgage loan exceeds the estimated net realizable value of the property.

The Company undertakes regular review of the loan portfolio to assess its risks, particularly the risks associated with the commercial loan portfolio. This includes annual review of every commercial loan representing credit exposure of \$150,000 or more. An independent firm performs semi-annual loan reviews for the Company.

Classified Assets FDIC regulations governing classification of assets require nonmember commercial banks — including the Company — to classify their own assets and to establish appropriate general and specific allowances for losses, subject to FDIC review. The regulations are designed to encourage management to evaluate assets on a case-by-case basis, discouraging automatic classifications. Under this classification system, problem assets of insured institutions

are classified as “substandard,” “doubtful,” or “loss.” An asset is considered “substandard” if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected. Assets classified as “doubtful” have all the weaknesses inherent in those classified substandard, with the added characteristic that the weaknesses make collection of principal in full — on the basis of currently existing facts, conditions, and values — highly questionable and improbable. Assets classified as “loss” are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. Assets that do not expose the Company to risk sufficient to warrant classification in one of the above categories, but that possess some weakness, are required to be designated “special mention” by management.

When an insured institution classifies assets as either “substandard” or “doubtful,” it may establish allowances for loan losses in an amount deemed prudent by management. When an insured institution classifies assets as “loss,” it is required either to establish an allowance for losses equal to 100% of that portion of the assets so classified or to charge off that amount. An Ohio nonmember bank’s determination about classification of its assets and the amount of its allowances is subject to review by the FDIC, which may order the establishment of additional loss allowances. Management also employs an independent third party to semi-annually review and validate the internal loan review process and loan classifications.

The Company has experienced a decrease in substandard loans. While it appears economic conditions within our defined market area have stabilized and may be improving, it is not yet evident that the improvement will be sustained. While the housing market seems to have stabilized, there is no evidence of a significant recovery to date. In addition, appraisal values are still below peak. Loans secured by residential real estate and commercial real estate account for \$12.1 million and \$7.3 million of the substandard loans, respectively. These amounts represent 73.5% of the Company’s substandard loans.

As of December 31, 2012, 2011, 2010, 2009, and 2008 consolidated classified loans were as follows:

Classified Loans at December 31,										
(Dollars in thousands)	2012		2011		2010		2009		2008	
	Amount	Percent of total loans	Amount	Percent of total loans	Amount	Percent of total loans	Amount	Percent of total loans	Amount	Percent of total loans
Classified loans:										
Special mention	\$ 3,364	0.82%	\$ 2,653	0.66%	\$ 2,868	0.77%	\$ 4,322	1.22%	\$ 5,134	1.60%
Substandard	26,459	6.48%	27,061	6.73%	28,178	7.56%	18,928	5.35%	5,350	1.66%
Doubtful	59	0.01%	73	0.02%	224	0.06%	277	0.08%	420	0.13%
Total amount due	<u>\$29,882</u>	<u>7.31%</u>	<u>\$29,787</u>	<u>7.41%</u>	<u>\$31,270</u>	<u>8.39%</u>	<u>\$23,527</u>	<u>6.65%</u>	<u>\$10,904</u>	<u>3.39%</u>

Other than those disclosed above, the Company does not believe there are any loans classified for regulatory purposes as loss, doubtful, substandard, special mention or otherwise, which will result in losses or have a material impact on future operations, liquidity or capital reserves. We are not aware of any other information that causes us to have serious doubts as to the ability of borrowers in general to comply with repayment terms.

Investments Investment securities provide a return on residual funds after lending activities. Investments may be in federal funds sold, corporate securities, U.S. Government and agency obligations, state and local government obligations and government-guaranteed, mortgage-backed securities. The Company generally does not invest in securities that are rated less than investment grade by a nationally recognized statistical rating organization. Ohio bank law prescribes the kinds of investments an Ohio-chartered bank may make. Permitted investments include local, state, and federal government securities, mortgage-backed securities, and securities of federal government agencies. An Ohio-chartered bank also may invest up to 10% of its assets in corporate debt and equity securities, or a higher percentage in certain circumstances. Similar to the legal lending limit on loans to any one borrower, Ohio bank law also limits to 15% of capital the amount an Ohio-chartered bank may invest in the securities of any one issuer, other than local, state, and federal government and federal government agency issuers and mortgage-backed securities issuers. These Ohio bank law provisions have not been a material constraint upon the Company’s investment activities.

All securities-related activity is reported to the Company's board of directors. General changes in investment strategy are required to be reviewed and approved by the board. Senior management can purchase and sell securities in accordance with the Company's stated investment policy.

Management determines the appropriate classification of securities at the time of purchase. At this time the Company has no securities that are classified as held-to-maturity. Securities to be held for indefinite periods and not intended to be held to maturity or on a long-term basis are classified as available-for-sale. Available-for-sale securities are reflected on the balance sheet at their fair value.

The following table exhibits the consolidated amortized cost and fair value of the Company's investment portfolio:

(Dollars in thousands)	Investment Portfolio Amortized Cost and Fair Value at December 31,					
	2012		2011		2010	
	Amortized cost	Fair value	Amortized cost	Fair value	Amortized cost	Fair value
Available for Sale:						
U.S. Government agency securities	\$ 24,485	\$ 24,960	\$ 31,520	\$ 31,933	\$ 33,332	\$ 32,603
Obligations of states and political subdivisions:						
Taxable	6,888	7,626	8,207	8,973	7,371	7,417
Tax-exempt	80,391	84,970	75,807	79,427	69,363	69,463
Mortgage-backed securities in government sponsored entities	69,238	71,102	63,808	65,573	73,390	74,043
Private-label mortgage-backed securities	4,553	5,064	7,005	7,321	16,636	17,326
Equity securities in financial institutions	750	750	750	750	944	920
Total Investment Securities	<u>\$ 186,305</u>	<u>\$ 194,472</u>	<u>\$ 187,097</u>	<u>\$ 193,977</u>	<u>\$ 201,036</u>	<u>\$ 201,772</u>

The contractual maturity of investment debt securities is as follows:

	December 31, 2012										
	One year or less		More than one to five years		More than five to ten years		More than ten years		Total investment securities		
	Amortized cost	Average yield	Amortized cost	Average yield	Amortized cost	Average yield	Amortized cost	Average yield	Amortized cost	Average yield	Fair value
(Dollars in thousands)											
U.S. Government agency securities	\$ -	-%	\$ -	-%	\$ 9,874	1.81%	\$ 14,611	3.08%	\$ 24,485	2.57%	\$ 24,960
Obligations of states and political subdivisions:											
Taxable	-	-	-	-	820	4.96	6,068	5.37	6,888	5.32	7,626
Tax-exempt **	2,081	6.29	4,964	5.68	11,020	5.53	62,326	5.43	80,391	5.48	84,970
Mortgage-backed securities in government-sponsored entities	98	3.96	-	-	596	5.37	68,544	2.48	69,238	2.50	71,102
Private-label mortgage-backed securities	-	-	591	5.57	-	-	3,962	4.93	4,553	5.01	5,064
Total	<u>\$ 2,179</u>	<u>6.19%</u>	<u>\$ 5,555</u>	<u>5.67%</u>	<u>\$ 22,310</u>	<u>3.86%</u>	<u>\$ 155,511</u>	<u>3.89%</u>	<u>\$ 185,555</u>	<u>3.97%</u>	<u>\$193,722</u>
** Tax equivalent yield											

Expected maturities of investment securities could differ from contractual maturities because the borrower, or issuer, could have the right to call or prepay obligations with or without call or prepayment penalties. The average yields in the above table are not calculated on a tax-equivalent basis.

As of December 31, 2012, the Company also held 18,872 shares of \$100 par value Federal Home Loan Bank of Cincinnati stock, which is a restricted security. FHLB stock represents an equity interest in the FHLB, but it does not have a readily determinable market value. The stock can be sold at its par value only, and only to the FHLB or to another member institution. Member institutions are required to maintain a minimum stock investment in the FHLB, based on total assets, total mortgages, and total mortgage-backed securities. The Company's minimum investment in FHLB stock at December 31, 2012 was \$1,887,200.

Sources of Funds — Deposit Accounts Deposit accounts are a major source of funds for the Company. The Company offers a number of deposit products to attract both commercial and regular consumer checking and savings customers, including regular and money market savings accounts, NOW accounts, and a variety of fixed-maturity, fixed-rate certificates with maturities ranging from seven days to 60 months. These accounts earn interest at rates established by management based on competitive market factors and management's desire to increase certain types or maturities of deposit liabilities. The Company also provides travelers' checks, official checks, money orders, ATM services, and IRA accounts.

The following table shows on a consolidated basis the amount of time deposits of \$100,000 or more as of December 31, 2012, including certificates of deposit, by time remaining until maturity.

(Dollar amounts in thousands)	Amount	Percent of Total
Within three months	\$ 10,031	12.55%
Beyond three but within six months	9,005	11.27
Beyond six but within twelve months	18,234	22.82
Beyond one year	42,648	53.36
Total	<u>\$ 79,918</u>	<u>100.00%</u>

Borrowings Deposits and repayment of loan principal are the Company's primary sources of funds for lending activities and other general business purposes. However, when the supply of lendable funds or funds available for general business purposes cannot satisfy the demand for loans or general business purposes, the Company's subsidiary banks can obtain funds from the FHLB of Cincinnati. Interest and principal are payable monthly, and the line of credit is secured by a pledge collateral agreement. At December 31, 2012, MBC had \$4.7 million of FHLB borrowings outstanding. The Company's subsidiary banks also have access to credit through the Federal Reserve Bank of Cleveland and other funding sources.

The outstanding balances and related information about short-term borrowings as of December 31, which includes securities sold under agreements to repurchase, lines of credit with other banks and Federal Funds purchased are summarized on a consolidated basis as follows:

(Dollar amounts in thousands)	2012	2011	2010
Balance at year-end	\$ 6,538	\$ 7,392	\$ 7,632
Average balance outstanding	7,005	7,276	7,320
Maximum month-end balance	7,458	7,552	8,178
Weighted-average rate at year-end	2.97 %	3.14 %	3.10%
Weighted-average rate during the year	3.15 %	3.23 %	3.40%

Personnel

As of December 31, 2012 the Company had 120 full-time equivalent employees. None of the employees are represented by a collective bargaining group. Management considers its relations with employees to be excellent.

Supervision and Regulation

The following discussion of bank supervision and regulation is qualified in its entirety by reference to the statutory and regulatory provisions discussed. Changes in applicable law or in the policies of various regulatory authorities could affect materially the business and prospects of the Company.

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956. As such, the Company is subject to regulation, supervision, and examination by the Board of Governors of the Federal Reserve System, acting primarily through the Federal Reserve Bank of Cleveland. The Company is required to file annual reports and other information with the Federal Reserve. Both bank subsidiaries are Ohio-chartered commercial banks. As a state-chartered, nonmember banks, the banks are primarily regulated by the FDIC and by the Ohio Division of Financial Institutions.

The Company and its subsidiary Banks are subject to federal banking laws, and the Company is also subject also to Ohio bank law. These federal and state laws are intended to protect depositors, not stockholders. Federal and state laws applicable to holding companies and their financial institution subsidiaries regulate the range of permissible business activities, investments, reserves against deposits, capital levels, lending activities and practices, the nature and amount of collateral for loans, establishment of branches, mergers, dividends, and a variety of other important matters. The Company is subject to detailed, complex, and sometimes overlapping federal and state statutes and regulations affecting routine banking operations. These statutes and regulations include but are not limited to state usury and consumer credit

laws, the Truth-in-Lending Act and Regulation Z, the Equal Credit Opportunity Act and Regulation B, the Fair Credit Reporting Act, the Truth in Savings Act, and the Community Reinvestment Act. The Company must comply with Federal Reserve Board regulations requiring depository institutions to maintain reserves against their transaction accounts (principally NOW and regular checking accounts). Because required reserves are commonly maintained in the form of vault cash or in a noninterest-bearing account (or pass-through account) at a Federal Reserve Bank, the effect of the reserve requirement is to reduce an institution's earning assets.

The Federal Reserve Board and the FDIC have extensive authority to prevent and to remedy unsafe and unsound practices and violations of applicable laws and regulations by institutions and holding companies. The agencies may assess civil money penalties, issue cease-and-desist or removal orders, seek injunctions, and publicly disclose those actions. In addition, the Ohio Division of Financial Institutions possesses enforcement powers to address violations of Ohio banking law by Ohio-chartered banks.

In February of 2011, Emerald Bank agreed with the FDIC and the Ohio Division of Financial Institutions that Emerald Bank will take specified actions to correct weaknesses in the bank's condition and operations. The actions that Emerald Bank agreed to take include reducing the bank's concentration of credit in non-owner occupied 1 - 4 family residential mortgage loans, reducing delinquent and classified loans, enhancing credit administration for non-owner occupied residential real estate, developing plans for the reduction of borrower indebtedness on classified and delinquent credits, implementing an earnings improvement plan, maintaining leverage capital of at least 9%, revising the bank's methodology for calculating and determining the adequacy of the allowance for loan losses, and providing to the FDIC and the ODFI notice of proposed dividend payments at least 30 days in advance.

The following table sets forth the capital requirements for EB under the FDIC regulations and EB's capital ratios:

Capital Ratio	FDIC Regulations		December 31, 2012	December 31, 2011
	Adequately Capitalized	Well Capitalized		
Tier I Leverage Capital	4.00%	5.00%(1)	10.61%	9.92%
Risk-Based Capital:				
Tier I	4.00	6.00	14.16	12.57
Total	8.00	10.00	15.45	13.82

(1) EB has agreed to maintain leverage capital of at least 9%

Regulation of Bank Holding Companies — *Bank and Bank Holding Company Acquisitions* The Bank Holding Company Act requires every bank holding company to obtain approval of the Federal Reserve before —

- directly or indirectly acquiring ownership or control of any voting shares of another bank or bank holding company, if after the acquisition the acquiring company would own or control more than 5% of the shares of the other bank or bank holding company (unless the acquiring company already owns or controls a majority of the shares),
- acquiring all or substantially all of the assets of another bank, or
- merging or consolidating with another bank holding company.

The Federal Reserve will not approve an acquisition, merger, or consolidation that would have a substantially anticompetitive result, unless the anticompetitive effects of the proposed transaction are clearly outweighed by a greater public interest in satisfying the convenience and needs of the community to be served. The Federal Reserve also considers capital adequacy and other financial and managerial factors in its review of acquisitions and mergers.

Additionally, the Bank Holding Company Act, the Change in Bank Control Act and the Federal Reserve Board's Regulation Y require advance approval of the Federal Reserve to acquire "control" of a bank holding company. Control is conclusively presumed to exist if an individual or company acquires 25% or more of a class of voting securities of the bank holding company. If the holding company has securities registered under Section 12 of the Securities Exchange Act of 1934, as the Company does, or if no other person owns a greater percentage of the class of voting securities, control is

presumed to exist if a person acquires 10% or more, but less than 25%, of any class of voting securities. Approval of the Ohio Division of Financial Institutions is also necessary to acquire control of an Ohio-chartered bank.

Nonbanking Activities With some exceptions, the Bank Holding Company Act has for many years also prohibited a bank holding company from acquiring or retaining direct or indirect ownership or control of more than 5% of the voting shares of any company that is not a bank or bank holding company, or from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. The principal exceptions to these prohibitions involve non-bank activities that, by statute or by Federal Reserve Board regulation or order, are held to be closely related to the business of banking or of managing or controlling banks. In making its determination that a particular activity is closely related to the business of banking, the Federal Reserve considers whether the performance of the activities by a bank holding company can be expected to produce benefits to the public — such as greater convenience, increased competition, or gains in efficiency in resources — that will outweigh the risks of possible adverse effects such as decreased or unfair competition, conflicts of interest, or unsound banking practices. Some of the activities determined by Federal Reserve Board regulation to be closely related to the business of banking are: making or servicing loans or leases; engaging in insurance and discount brokerage activities; owning thrift institutions; performing data processing services; acting as a fiduciary or investment or financial advisor; and making investments in corporations or projects designed primarily to promote community welfare.

Financial Holding Companies On November 12, 1999 the Gramm-Leach-Bliley Act became law, repealing much of the 1933 Glass-Steagall Act's separation of the commercial and investment banking industries. The Gramm-Leach-Bliley Act expands the range of nonbanking activities a bank holding company may engage in, while preserving existing authority for bank holding companies to engage in activities that are closely related to banking. The new legislation creates a new category of holding company called a "financial holding company." Financial holding companies may engage in any activity that is —

- financial in nature or incidental to that financial activity, or
- complementary to a financial activity and that does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

Activities that are financial in nature include —

- acting as principal, agent, or broker for insurance,
- underwriting, dealing in, or making a market in securities, and
- providing financial and investment advice.

The Federal Reserve Board and the Secretary of the Treasury have authority to decide that other activities are also financial in nature or incidental to financial activity, taking into account changes in technology, changes in the banking marketplace, competition for banking services, and so on. The Company is engaged solely in activities that were permissible for a bank holding company before enactment of the Gramm-Leach-Bliley Act. Federal Reserve Board rules require that all of the depository institution subsidiaries of a financial holding company be and remain well capitalized and well managed. If all depository institution subsidiaries of a financial holding company do not remain well capitalized and well managed, the financial holding company must enter into an agreement acceptable to the Federal Reserve Board, undertaking to comply with all capital and management requirements within 180 days. In the meantime the financial holding company may not use its expanded authority to engage in nonbanking activities without Federal Reserve Board approval and the Federal Reserve may impose other limitations on the holding company's or affiliates' activities. If a financial holding company fails to restore the well-capitalized and well-managed status of a depository institution subsidiary, the Federal Reserve may order divestiture of the subsidiary. Until late 2009 the Company was entitled to engage in the expanded range of activities in which a financial holding company, as defined in Federal Reserve Board rules, may engage. The Company continues to be entitled to engage in activities deemed permissible to a bank holding company, as defined by Federal Reserve Board rules and the applicable laws of the United States.

Holding Company Capital and Source of Strength The Federal Reserve considers the adequacy of a bank holding company's capital on essentially the same risk-adjusted basis as capital adequacy is determined by the FDIC at the bank subsidiary level. In general, bank holding companies are required to maintain a minimum ratio of total capital to risk-weighted assets of 8% and Tier 1 capital — consisting principally of stockholders' equity — of at least 4%. Bank

holding companies are also subject to a leverage ratio requirement. The minimum required leverage ratio for the very highest rated companies is 3%, but as a practical matter the minimum required leverage ratio for most bank holding companies is 4% or higher. It is also Federal Reserve Board policy that bank holding companies serve as a source of strength for their subsidiary banking institutions.

Under Bank Holding Company Act section 5(e), the Federal Reserve Board may require a bank holding company to terminate any activity or relinquish control of a nonbank subsidiary if the Federal Reserve Board determines that the activity or control constitutes a serious risk to the financial safety, soundness or stability of a subsidiary bank. And with the Federal Deposit Insurance Corporation Improvement Act of 1991's addition of the prompt corrective action provisions to the Federal Deposit Insurance Act, section 38(f)(2)(I) of the Federal Deposit Insurance Act now provides that a federal bank regulatory authority may require a bank holding company to divest itself of an undercapitalized bank subsidiary if the agency determines that divestiture will improve the bank's financial condition and prospects.

Liability of Commonly Controlled Institutions Adding subsection (e) to section 5 of the Federal Deposit Insurance Act, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 allows the FDIC to demand from one institution payment for losses incurred or to be incurred by the FDIC because of the default of another institution or because of assistance provided by the FDIC to the other institution in danger of default, if the institutions are commonly controlled.

Capital — Risk-Based Capital Requirements The Federal Reserve Board and the FDIC employ similar risk-based capital guidelines in their examination and regulation of bank holding companies and financial institutions. If capital falls below the minimum levels established by the guidelines, the bank holding company or bank may be denied approval to acquire or establish additional banks or non-bank businesses or to open new facilities. Failure to satisfy capital guidelines could subject a banking institution to a variety of restrictions or enforcement actions by federal bank regulatory authorities, including the termination of deposit insurance by the FDIC and a prohibition on the acceptance of "brokered deposits."

A bank's capital hedges its risk exposure, absorbing losses that can be predicted as well as losses that cannot be predicted. According to the Federal Financial Institutions Examination Council's explanation of the capital component of the Uniform Financial Institutions Rating System, commonly known as the "CAMELS" rating system, a rating system employed by the Federal bank regulatory agencies, a financial institution must "maintain capital commensurate with the nature and extent of risks to the institution and the ability of management to identify, measure, monitor, and control these risks. The effect of credit, market, and other risks on the institution's financial condition should be considered when evaluating the adequacy of capital." The minimum ratio of total capital to risk-weighted assets is 8.0%, of which at least 4.0% must consist of so-called Tier 1 capital. The minimum Tier 1 leverage ratio – Tier 1 capital to average assets – is 3.0% for the highest rated institutions and at least 4.0% for all others. These ratios are absolute minimums. In practice, banks are expected to operate with more than the absolute minimum capital. The FDIC may establish greater minimum capital requirements for specific institutions.

Tier 1 capital consists of common stock, retained earnings, non-cumulative perpetual preferred stock, trust preferred securities up to a certain limit, and minority interests in certain subsidiaries, less most other intangible assets. Tier 2 capital consists of preferred stock not qualifying as Tier 1 capital, limited amounts of subordinated debt, other qualifying term debt, a limited amount of the allowance for loan and lease losses, and certain other instruments that have some characteristics of equity. To determine risk-weighted assets, the nominal dollar amounts of assets on the balance sheet and credit-equivalent amounts of off-balance-sheet items are multiplied by one of several risk adjustment percentages ranging from 0.0% for assets considered to have low credit risk, such as cash and certain U.S. government securities, to 100.0% for assets with relatively higher credit risk, such as business loans, and a 200% risk-weight for selected investments that are rated below investment grade or, if not rated, that are equivalent to investments rated below investment grade. A banking organization's risk-based capital ratios are obtained by dividing its Tier 1 capital and total qualifying capital (Tier 1 capital and a limited amount of Tier 2 capital) by its total risk-adjusted assets.

The FDIC also employs a market risk component in its calculation of capital requirements for nonmember banks. The market risk component could require additional capital for general or specific market risk of trading portfolios of debt and equity securities and other investments or assets. The FDIC's evaluation of an institution's capital adequacy takes account of a variety of other factors as well, including interest rate risks to which the institution is subject, the level and quality of an institution's earnings, loan and investment portfolio characteristics and risks, risks arising from the conduct of nontraditional activities, and a variety of other factors.

Accordingly, the FDIC's final supervisory judgment concerning an institution's capital adequacy could differ significantly from the conclusions that might be derived from the absolute level of an institution's risk-based capital ratios. Therefore, institutions generally are expected to maintain risk-based capital ratios that exceed the minimum ratios discussed above. This is particularly true for institutions contemplating significant expansion plans and institutions that are subject to high or inordinate levels of risk. Moreover, although the FDIC does not impose explicit capital requirements on holding companies of institutions regulated by the FDIC, the FDIC can take account of the degree of leverage and risks at the holding company level. If the FDIC determines that the holding company (or another affiliate of the institution regulated by the FDIC) has an excessive degree of leverage or is subject to inordinate risks, the FDIC may require the subsidiary institution(s) to maintain additional capital or the FDIC may impose limitations on the subsidiary institution's ability to support its weaker affiliates or holding company.

The banking agencies have also established a minimum leverage ratio of 3%, which represents Tier 1 capital as a percentage of total assets, less intangibles. However, for bank holding companies and financial institutions seeking to expand and for all but the most highly rated banks and bank holding companies, the banking agencies expect an additional cushion of at least 100 to 200 basis points. At December 31, 2012, the Company was in compliance with all regulatory capital requirements.

Prompt Corrective Action . To resolve the problems of undercapitalized institutions and to prevent a recurrence of the banking crisis of the 1980s and early 1990s, the Federal Deposit Insurance Corporation Improvement Act of 1991 established a system known as "prompt corrective action." Under the prompt corrective action provisions and implementing regulations, every institution is classified into one of five categories, depending on its total risk-based capital ratio, its Tier 1 risk-based capital ratio, its leverage ratio, and subjective factors. The categories are "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized." To be considered well capitalized for purposes of the prompt corrective action rules, a bank must maintain total risk-based capital of 10.0% or greater, Tier 1 risk-based capital of 6.0% or greater, and leverage capital of 5.0% or greater. An institution with a capital level that might qualify for well-capitalized or adequately capitalized status may nevertheless be treated as though it were in the next lower capital category if its primary federal banking supervisory authority determines that an unsafe or unsound condition or practice warrants that treatment.

A financial institution's operations can be significantly affected by its capital classification under the prompt corrective action rules. For example, an institution that is not well capitalized generally is prohibited from accepting brokered deposits and offering interest rates on deposits higher than the prevailing rate in its market without advance regulatory approval, which can have an adverse effect on the bank's liquidity. At each successively lower capital category, an insured depository institution is subject to additional restrictions. Undercapitalized institutions are required to take specified actions to increase their capital or otherwise decrease the risks to the federal deposit insurance funds. A bank holding company must guarantee that a subsidiary bank that adopts a capital restoration plan will satisfy its plan obligations. Any capital loans made by a bank holding company to a subsidiary bank are subordinated to the claims of depositors in the bank and to certain other indebtedness of the subsidiary bank. If bankruptcy of a bank holding company occurs, any commitment by the bank holding company to a Federal banking regulatory agency to maintain the capital of a subsidiary bank would be assumed by the bankruptcy trustee and would be entitled to priority of payment. Bank regulatory agencies generally are required to appoint a receiver or conservator shortly after an institution becomes critically undercapitalized.

The following table illustrates the capital and prompt corrective action guidelines applicable to the Company and its subsidiaries, as well as its total risk-based capital ratio, Tier 1 capital ratio and leverage ratio.

(Dollar amounts in thousands)	Middlefield Banc Corp. December 31, 2012		The Middlefield Banking Co. December 31, 2012		Emerald Bank December 31, 2012	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to Risk-weighted Assets)						
Actual	\$ 57,784	13.86%	\$ 47,887	13.29%	\$ 8,440	15.45%
For Capital Adequacy Purposes	33,344	8.00	28,822	8.00	4,370	8.00
To Be Well Capitalized	41,680	10.00	36,027	10.00	5,463	10.00
Tier I Capital (to Risk-weighted Assets)						
Actual	\$ 52,543	12.61%	\$ 43,371	12.04%	\$ 7,737	14.16%
For Capital Adequacy Purposes	16,672	4.00	14,411	4.00	2,185	4.00
To Be Well Capitalized	25,008	6.00	21,616	6.00	3,278	6.00
Tier I Capital (to Average Assets)						
Actual	\$ 52,543	7.88%	\$ 43,371	7.32%	\$ 7,737	10.61%
For Capital Adequacy Purposes	26,675	4.00	23,684	4.00	2,916	4.00
To Be Well Capitalized	33,344	5.00	29,605	5.00	3,646	5.00

Supplementing these capital requirements of applicable banking regulations, Emerald Bank has agreed with the FDIC and the Ohio Division of Financial Institutions to maintain tier 1 leverage capital of at least 9%, The Middlefield Banking Company committed to the FDIC that The Middlefield Banking Company will maintain capital ratios at levels no lower than its June 30, 2010 ratios (*i.e.*, no lower than 6.25% tier 1 leverage capital and 11.29% total risk-based capital), and Middlefield Banc Corp. committed to the Federal Reserve that Middlefield Banc Corp. will maintain tier 1 leverage capital of at least 7.25% and total risk-based capital of at least 12%, both at the level of the holding company and at the level of The Middlefield Banking Company, the lead bank. We expect that these elevated minimum capital levels will apply for the foreseeable future, while the banks and the holding company continue their efforts to manage more serious asset quality challenges than they have been accustomed to, while also managing the impact of those challenges on earnings and the strains that general economic downturns in the banks' markets and across the region and nation are placing not only on Emerald Bank and The Middlefield Banking Company but on all local banks.

Limits on Dividends and Other Payments The Company's ability to obtain funds for the payment of dividends and for other cash requirements depends on the amount of dividends that may be paid to it by the banks. Ohio bank law and FDIC policy are consistent, providing that banks generally may rely solely on current earnings for the payment of dividends. Under Ohio Revised Code section 1107.15(B) a dividend may be declared from surplus, meaning additional paid-in capital, with the approval of (x) the Ohio Superintendent of Financial Institutions and (y) the holders of two thirds of the bank's outstanding shares. Superintendent approval is also necessary for payment of a dividend if the total of all cash dividends in a year exceeds the sum of (x) net income for the year and (y) retained net income for the two preceding years. Relying on 12 U.S.C. 1818(b), the FDIC may restrict a bank's ability to pay a dividend if the FDIC has reasonable cause to believe that the dividend would constitute an unsafe and unsound practice. A bank's ability to pay dividends may be affected also by the FDIC's capital maintenance requirements and prompt corrective action rules. A bank may not pay a dividend if the bank is undercapitalized or if payment would cause the bank to become undercapitalized.

A 1985 policy statement of the Federal Reserve Board declares that a bank holding company should not pay cash dividends on common stock unless the organization's net income for the past year is sufficient to fully fund the dividends and the prospective rate of earnings retention appears consistent with the organization's capital needs, asset quality, and overall financial condition.

The Dodd-Frank Act A landmark financial reform bill, the Dodd-Frank Wall Street Reform and Consumer Protection Act became law on July 21, 2010, changing the Federal bank regulatory structure and affecting the lending, investment, trading, and other operating activities of financial institutions and holding companies. The Dodd-Frank Act includes corporate governance and executive compensation reforms, new registration requirements for hedge fund and private equity fund advisers, increased regulation of over-the-counter derivatives and asset-backed securities, and new rules for credit rating agencies. Over 2,000 pages long, the Dodd-Frank Act includes these provisions –

- section 111 establishes a new Financial Stability Oversight Council to monitor systemic financial risks. The Board of Governors of the Federal Reserve is given extensive new authorities to impose strict controls on large bank holding companies with total consolidated assets equal to or exceeding \$50 billion and systemically significant non-bank financial companies to limit the risk they might pose for the economy and to other large interconnected companies. The Dodd-Frank Act also grants to the Treasury Department, FDIC and the FRB broad new powers to seize, close and wind-down “too big to fail” financial institutions (including non-bank institutions) in an orderly fashion.
- Title X establishes an independent Federal regulatory body within the Federal Reserve System. Dedicated exclusively to consumer protection and known as the Bureau of Consumer Financial Protection, this new regulatory body has responsibility for most consumer protection laws, with rulemaking, supervisory, examination, and enforcement authority. The Bureau of Consumer Financial Protection will also be in charge of setting appropriate consumer banking fees and caps. According to Dodd-Frank Act section 1025, the new regulatory body has examination and enforcement authority over banks with more than \$10 billion in assets, but under section 1026 banks with assets of \$10 billion or less will continue to be examined by their bank regulators for consumer law compliance. In addition, the Dodd-Frank Act permits states to adopt consumer protection laws and regulations that are stricter than those regulations promulgated by the Consumer Financial Protection Bureau. Compliance with any such new regulations would increase our cost of operations and could as a result limit our ability to expand into these products and services.
- section 171 restricts the amount of trust preferred securities that may be considered Tier 1 capital. For depository institution holding companies with total assets of less than \$15 billion, trust preferred securities issued before May 19, 2010 may continue to be included in Tier 1 capital, but future issuances of trust preferred securities will no longer be eligible for treatment as Tier 1 capital.
- under section 334 the FDIC’s minimum reserve ratio is to be increased from 1.15% to 1.35%, with the goal of attaining that 1.35% level by September 30, 2020; however, financial institutions with assets of less than \$10 billion are to be exempt from the cost of the increase. The Dodd-Frank Act also removes the upper limit on the designated reserve ratio, which was formerly capped at 1.5%, removing the upper limit on the size of the insurance fund as a consequence. The Dodd-Frank Act gives the FDIC much greater discretion to manage its insurance fund reserves, including where to set the insurance fund’s designated reserve ratio.
- the deposit insurance cover limit is increased to \$250,000 by section 335.
- section 627 repeals the longstanding prohibition against financial institutions paying interest on checking accounts.
- section 331 changes the way deposit insurance premiums are calculated by the FDIC as well. That is, deposit insurance premiums are calculated based upon an institution’s so-called assessment base. Until the Dodd-Frank Act became law, the assessment base consisted of an institution’s deposit liabilities. Section 331, however, makes clear that the assessment base shall now be the difference between total assets and tangible equity. In other words, the assessment base will take account of all liabilities, not merely deposit liabilities. This change is likely to have a greater impact on large banks, which tend to rely on a variety of funding sources, than on community banks, which tend to rely primarily on deposit funding.
- the Office of the Comptroller of the Currency’s ability to preempt state consumer protection laws is constrained by section 1044, and because of section 1042 state attorneys general have greater authority to enforce state consumer protection laws against national banks and their operating subsidiaries.

- section 604 requires the Federal bank regulatory agencies to take into account the risks to the stability of the U.S. banking or financial system associated with approval of an application for acquisition of a bank, for acquisition of a nonbank company, or for a bank merger transaction.
- section 619 implements the so-called “Volcker rule,” prohibiting a banking entity from engaging in proprietary trading or from sponsoring or investing in a hedge fund or private equity fund.
- imposing a 5% risk retention requirement on securitizers of asset-backed securities, section 941 could have an impact on financial institutions that originate mortgages for sale into the secondary market. Like other provisions of the Dodd-Frank Act, the scope and impact of section 941 will be determined by future rulemaking.

The Dodd-Frank Act could affect the profitability of community banking, require changes in the business practices of community banking organizations, lead to more stringent capital and liquidity requirements, and otherwise adversely affect the community banking business. However, because much of the Dodd-Frank Act will be phased in over time and will not become effective until Federal agency rulemaking initiatives are completed, we cannot predict with confidence precisely how the Dodd-Frank Act will affect community banking organizations. We are confident, however, that short- and long-term compliance costs for all financial organizations, both large and small, will be greater because of the Dodd-Frank Act.

Sarbanes-Oxley Act of 2002 The goals of the Sarbanes-Oxley Act enacted in 2002 are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies, and to protect investors by improving the accuracy and reliability of corporate disclosures made under the securities laws. The changes are intended to allow shareholders to monitor the performance of companies and directors more easily and efficiently.

The Sarbanes-Oxley Act generally applies to all companies that file or are required to file periodic reports with the SEC under the Securities Exchange Act of 1934. The Act has an impact on a wide variety of corporate governance and disclosure issues, including the composition of audit committees, certification of financial statements by the chief executive officer and the chief financial officer, forfeiture of bonuses and profits made by directors and senior officers in the 12-month period covered by restated financial statements, a prohibition on insider trading during pension plan blackout periods, disclosure of off-balance sheet transactions, a prohibition on personal loans to directors and officers (excluding Federally insured financial institutions), expedited filing requirements for stock transaction reports by officers and directors, the formation of a public accounting oversight board, auditor independence, and various increased criminal penalties for violations of securities laws.

Deposit Insurance The premium that banks pay for deposit insurance is based upon a risk classification system established by the FDIC. Banks with higher levels of capital and a low degree of supervisory concern are assessed lower premiums than banks with lower levels of capital or a higher degree of supervisory concern.

Interstate Banking and Branching Section 613 of the Dodd-Frank Act amends the interstate branching provisions of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. The expanded *de novo* branching authority of the Dodd-Frank Act authorizes a state or national bank to open a *de novo* branch in another state if the law of the state where the branch is to be located would permit a state bank chartered by that state to open the branch. Under prior law, an out-of-state bank could open a *de novo* branch in another state only if the particular state permitted out-of-state banks to establish a *de novo* branch. Section 607 of the Dodd-Frank Act also increases the approval threshold for interstate bank acquisitions, providing that a bank holding company must be well capitalized and well managed as a condition to approval of an interstate bank acquisition, rather than being merely adequately capitalized and adequately managed, and that an acquiring bank must be and remain well capitalized and well managed as a condition to approval of an interstate bank merger.

Transactions with Affiliates Although the banks are not member banks of the Federal Reserve System, they are required by the Federal Deposit Insurance Act to comply with section 23A and section 23B of the Federal Reserve Act — pertaining to transactions with affiliates — as if they were member banks. These statutes are intended to protect banks from abuse in financial transactions with affiliates, preventing federally insured deposits from being diverted to support the activities of unregulated entities engaged in nonbanking businesses. An affiliate of a bank includes any

company or entity that controls or is under common control with the bank. Generally, section 23A and section 23B of the Federal Reserve Act —

- limit the extent to which a bank or its subsidiaries may lend to or engage in various other kinds of transactions with any one affiliate to an amount equal to 10% of the institution's capital and surplus, limiting the aggregate of covered transactions with all affiliates to 20% of capital and surplus,
- impose restrictions on investments by a subsidiary bank in the stock or securities of its holding company,
- impose restrictions on the use of a holding company's stock as collateral for loans by the subsidiary bank,
- require that affiliate transactions be on terms substantially the same, or at least as favorable to the institution or subsidiary, as those provided to a non-affiliate, and
- Impose strict collateral requirements on loans or extensions of credit by a bank to an affiliate

The Company's authority to extend credit to insiders — meaning executive officers, directors and greater than 10% stockholders — or to entities those persons control, is subject to section 22(g) and section 22(h) of the Federal Reserve Act and Regulation O of the Federal Reserve Board. Among other things, these laws require insider loans to be made on terms substantially similar to those offered to unaffiliated individuals, place limits on the amount of loans a bank may make to insiders based in part on the Company's capital position, and require that specified approval procedures be followed. Loans to an individual insider may not exceed the legal limit on loans to any one borrower, which in general terms is 15% of capital but can be higher in some circumstances. And the aggregate of all loans to all insiders may not exceed the Company's unimpaired capital and surplus. Insider loans exceeding the greater of 5% of capital or \$25,000 must be approved in advance by a majority of the board, with any "interested" director not participating in the voting. Lastly, loans to executive officers are subject to special limitations. Executive officers may borrow in unlimited amounts to finance their children's education or to finance the purchase or improvement of their residence, and they may borrow no more than \$100,000 for most other purposes. Loans to executive officers exceeding \$100,000 may be allowed if the loan is fully secured by government securities or a segregated deposit account. A violation of these restrictions could result in the assessment of substantial civil monetary penalties, the imposition of a cease-and-desist order or other regulatory sanctions.

Banking agency guidance for commercial real estate lending In December 2006 the FDIC and other Federal banking agencies issued final guidance on sound risk management practices for concentrations in commercial real estate lending, including acquisition and development lending, construction lending, and other land loans, which recent experience has shown can be particularly high-risk lending. According to a 2009 FDIC publication, a majority of the community banks that became problem banks or failed in 2008 had similar risk profiles: the banks often had extremely high concentrations, relative to their capital, in residential acquisition, development, and construction lending, loan underwriting and credit administration functions at these institutions typically were criticized by examiners, and many of the institutions had exhibited rapid asset growth funded with brokered deposits.

The commercial real estate risk management guidance does not impose rigid limits on commercial real estate lending but does create a much sharper supervisory focus on the risk management practices of banks with concentrations in commercial real estate lending. According to the guidance, an institution that has experienced rapid growth in commercial real estate lending, has notable exposure to a specific type of commercial real estate, or is approaching or exceeds the following supervisory criteria may be identified for further supervisory analysis of the level and nature of its commercial real estate concentration risk —

- total reported loans for construction, land development, and other land represent 100% or more of the institution's total capital, or
- total commercial real estate loans represent 300% or more of the institution's total capital and the outstanding balance of the institution's commercial real estate loan portfolio has increased by 50% or more during the prior 36 months.

These measures are intended merely to enable the banking agencies to quickly identify institutions that could have an excessive commercial real estate lending concentration, potentially requiring close supervision to ensure that the institutions have sound risk management practices in place. Conversely, these measures do not imply that banks are authorized by the December 2006 guidance to accumulate a commercial real estate lending concentration up to the 100% and 300% thresholds.

Corporate Governance and Compensation The Federal banking agencies jointly published their final Guidance on Sound Incentive Compensation Policies in June of 2010. The goal of the guidance is to enable financial organizations to manage the safety and soundness risks of incentive compensation arrangements and to assist banks and bank holding companies with identification of improperly-structured compensation arrangements. To ensure that incentive compensation arrangements do not encourage employees to take excessive risks that undermine safety and soundness, the incentive compensation guidance sets forth these key principles –

- incentive compensation arrangements should provide employees incentives that appropriately balance risk and financial results in a manner that does not encourage employees to expose the organization to imprudent risk,
- these arrangements should be compatible with effective controls and risk management, and
- these arrangements should be supported by strong corporate governance, including active and effective oversight by the board of directors.

To implement the interagency guidance, a financial organization must regularly review incentive compensation arrangements for all executive and non-executive employees who, either individually or as part of a group, have the ability to expose the organization to material amounts of risk, also reviewing the risk-management, control, and corporate governance processes related to these arrangements. The organization must immediately correct any identified deficiencies in compensation arrangements or processes that are inconsistent with safety and soundness.

In addition to numerous provisions that affect the business of banks and bank holding companies, the Dodd-Frank Act includes in Title IX a number of provisions affecting corporate governance and executive compensation, for example the requirements that stockholders be given the opportunity to consider and vote upon executive compensation disclosed in a company's annual meeting proxy statement, that a company's compensation committee be comprised entirely of independent directors and that the committee have stated minimum authorities, that company policy provide for recovery of excess incentive compensation after an accounting restatement, and that stockholders have the ability to designate director nominees for inclusion in a company's annual meeting proxy statement. Section 956 also provides for adoption of incentive compensation guidelines jointly by the Federal banking agencies and the SEC, the National Credit Union Administration, and the Federal Housing Finance Agency.

Overdraft Protection Practices Federal Reserve rules regarding overdraft charges for debit card and ATM transactions became effective on July 1, 2010, eliminating the automatic overdraft protection arrangements that had been in common use and requiring instead that banks notify customers and obtain their consent before enrolling them in an overdraft protection plan. The rules limit a bank's ability to charge fees for the payment of overdrafts for debit and ATM card transactions. On November 24, 2010, the FDIC issued final supervisory guidance on overdraft protection programs and related consumer protection issues. Applicable only to nonmember banks regulated by the FDIC, the guidance emphasizes that banks should be alert to consumers' use of automated overdraft protection programs in a way that is harmful, as opposed to using the coverage as protection against occasional errors or funds shortages. Programs in which a bank employee exercises discretion over whether an overdraft should be paid as an accommodation to a customer and linked lines of credit are not covered. Effective July 1, 2011, FDIC-regulated nonmember banks like The Middlefield Banking Company or Emerald Bank must monitor their programs for "excessive or chronic customer use," including a customer overdrawing an account and being charged a fee on more than six occasions in 12 months. In such a case, the bank should contact the customer to discuss better alternatives and give the customer the chance to decide whether to continue to use the automated overdraft protection program. FDIC-regulated nonmember banks must implement daily limits on customer costs.

The FDIC's supervisory guidance concerning automated overdraft payment programs requires banks to consider whether to eliminate fees for transactions that result in significant overdrafts and requires banks to review check-clearing procedures to ensure that the order of clearing items does not operate to maximize fees. The FDIC suggests that clearing items in the order in which they are received or clearing checks by numerical order is appropriate. The supervisory

guidance provides that FDIC-regulated banks, including all state-chartered banks that have chosen not to become members of the Federal Reserve System, should give customers an opportunity to opt out of overdraft coverage for paper checks and automated clearing house transactions just as customers can opt out of ATM and point of sale transactions, even though the Federal Reserve Board's opt-out amendments to Regulation E—Electronic Fund Transfers did not apply to non-electronic transactions. The FDIC supervisory guidance imposes on state-chartered nonmember banks a burden that is not imposed by the OCC on national banks or by the Federal Reserve on state-chartered member banks.

In 2010, the FDIC created a new Division of Depositor and Consumer Protection to sharpen the agency's focus on consumer protection issues. Although the FDIC does not have rulemaking authority over statutes proscribing unfair or deceptive acts or practices ("UDAP") and other consumer laws, the FDIC does have examination and enforcement authority over state-chartered nonmember banks. Because of the FDIC's public advocacy against fee-based overdraft protection services that are considered by the FDIC to be abusive, FDIC-regulated nonmember banks could be at greater risk than other banks for claimed UDAP violations involving fee-based overdraft protection.

Community Reinvestment Act Under the Community Reinvestment Act of 1977 and implementing regulations of the banking agencies, a financial institution has a continuing and affirmative obligation — consistent with safe and sound operation — to address the credit needs of its entire community, including low- and moderate-income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions, nor does it limit an institution's discretion to develop the types of products and services it believes are best suited to its particular community. The CRA requires that bank regulatory agencies conduct regular CRA examinations and provide written evaluations of institutions' CRA performance. The CRA also requires that an institution's CRA performance rating be made public. CRA performance evaluations are based on a four-tiered rating system: Outstanding, Satisfactory, Needs to Improve and Substantial Noncompliance.

Although CRA examinations occur on a regular basis, CRA performance evaluations have been used principally in the evaluation of regulatory applications submitted by an institution. CRA performance evaluations are considered in evaluating applications for such things as mergers, acquisitions, and applications to open branches.

MBC's CRA performance evaluation dated June 7, 2011 states that MBC's CRA rating is "Satisfactory." EB's CRA performance evaluation dated February 17, 2011 states that EB's CRA rating is "Satisfactory."

Federal Home Loan Bank The Federal Home Loan Bank serves as a credit source for their members. As a member of the FHLB of Cincinnati, both MBC and EB are required to maintain an investment in the capital stock of the FHLB of Cincinnati in an amount calculated by reference to the FHLB member bank's amount of loans, and or "advances," from the FHLB. The Company is in compliance with this requirement, with an investment in FHLB stock on MBC's part of \$1.6 million and on EB's part of \$261,000 at December 31, 2012.

Each FHLB is required to establish standards of community investment or service that its members must maintain for continued access to long-term advances from the FHLB. The standards take into account a member's performance under the Community Reinvestment Act and its record of lending to first-time home buyers.

Anti-money laundering and anti-terrorism legislation The Bank Secrecy Act of 1970 requires financial institutions to maintain records and report transactions to prevent the financial institutions from being used to hide money derived from criminal activity and tax evasion. The Bank Secrecy Act establishes (a) record keeping requirements to assist government enforcement agencies with tracing financial transactions and flow of funds, (b) reporting requirements for Suspicious Activity Reports and Currency Transaction Reports to assist government enforcement agencies with detecting patterns of criminal activity, (c) enforcement provisions authorizing criminal and civil penalties for illegal activities and violations of the Bank Secrecy Act and its implementing regulations, and (d) safe harbor provisions that protect financial institutions from civil liability for their cooperative efforts.

The Treasury's Office of Foreign Asset Control administers and enforces economic and trade sanctions against targeted foreign countries, entities, and individuals based on U.S. foreign policy and national security goals. As a result, financial institutions must scrutinize transactions to ensure that they do not represent obligations of or ownership interests in entities owned or controlled by sanctioned targets.

Signed into law on October 26, 2001, the USA PATRIOT Act of 2001 is omnibus legislation enhancing the powers of domestic law enforcement organizations to resist the international terrorist threat to United States security. Title III of the legislation, the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001, most directly affects the financial services industry, enhancing the Federal government's ability to fight money laundering through monitoring of currency transactions and suspicious financial activities. The Act has significant implications for depository institutions and other businesses involved in the transfer of money –

- a financial institution must establish due diligence policies, procedures, and controls reasonably designed to detect and report money laundering through correspondent accounts and private banking accounts,
- no bank may establish, maintain, administer, or manage a correspondent account in the United States for a foreign shell bank,
- financial institutions must abide by Treasury Department regulations encouraging financial institutions, their regulatory authorities, and law enforcement authorities to share information about individuals, entities, and organizations engaged in or suspected of engaging in terrorist acts or money laundering activities,
- financial institutions must follow Treasury Department regulations setting forth minimum standards regarding customer identification. These regulations require financial institutions to implement reasonable procedures for verifying the identity of any person seeking to open an account, maintain records of the information used to verify the person's identity, and consult lists of known or suspected terrorists and terrorist organizations provided to the financial institution by government agencies,
- every financial institution must establish anti-money laundering programs, including the development of internal policies and procedures, designation of a compliance officer, employee training, and an independent audit function.

Consumer protection laws and regulations. The Middlefield Banking Company and Emerald Bank are subject to regular examination by the FDIC to ensure compliance with statutes and regulations applicable to the bank's business, including consumer protection statutes and implementing regulations, some of which are discussed below. Violations of any of these laws may result in fines, reimbursements, and other related penalties.

Equal Credit Opportunity Act. The Equal Credit Opportunity Act generally prohibits discrimination in any credit transaction, whether for consumer or business purposes, on the basis of race, color, religion, national origin, sex, marital status, age (except in limited circumstances), receipt of income from public assistance programs, or good faith exercise of any rights under the Consumer Credit Protection Act.

Truth in Lending Act. The Truth in Lending Act is designed to ensure that credit terms are disclosed in a meaningful way so that consumers may compare credit terms more readily and knowledgeably. As a result of the Truth in Lending Act, all creditors must use the same credit terminology to express rates and payments, including the annual percentage rate, the finance charge, the amount financed, the total of payments and the payment schedule, among other things.

Fair Housing Act. The Fair Housing Act makes it unlawful for a lender to discriminate against any person because of race, color, religion, national origin, sex, handicap, or familial status. A number of lending practices have been held by the courts to be illegal under the Fair Housing Act, including some practices that are not specifically mentioned in the Federal Housing Act.

Home Mortgage Disclosure Act. The Home Mortgage Disclosure Act arose out of public concern over credit shortages in certain urban neighborhoods. The Home Mortgage Disclosure Act requires financial institutions to collect data that enable regulatory agencies to determine whether the financial institutions are serving the housing credit needs of the neighborhoods and communities in which they are located. The Home Mortgage Disclosure Act also requires the collection and disclosure of data about applicant and borrower characteristics as a way to identify possible discriminatory lending patterns. The vast amount of information that financial institutions collect and disclose concerning applicants and borrowers receives attention not only from state and Federal banking supervisory authorities but also from community-oriented organizations and the general public.

Real Estate Settlement Procedures Act. The Real Estate Settlement Procedures Act requires that lenders provide borrowers with disclosures regarding the nature and cost of real estate settlements. The Real Estate Settlement Procedures Act also prohibits abusive practices that increase borrowers' costs, such as kickbacks and fee-splitting without providing settlement services.

Privacy. Under the Gramm-Leach-Bliley Act, all financial institutions are required to establish policies and procedures to restrict the sharing of non-public customer data with non-affiliated parties and to protect customer data from unauthorized access. In addition, the Fair Credit Reporting Act of 1971 includes many provisions concerning national credit reporting standards and permits consumers to opt out of information-sharing for marketing purposes among affiliated companies.

Predatory lending. What is commonly referred to as predatory typically involves one or more of the following elements –

- making unaffordable loans based on a borrower's assets rather than the consumer's ability to repay an obligation,
- inducing a consumer to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced, or loan flipping, and
- engaging in fraud or deception to conceal the true nature of the loan obligation from an unsuspecting or unsophisticated consumer.

The Home Ownership and Equity Protection Act of 1994 and implementing regulations require specified disclosures and extend additional protection to consumers in closed-end consumer credit transactions that are secured by a mortgage on the borrower's primary residence. The disclosures and protections are applicable to "high cost" transactions with any of the following features –

- interest rates for first lien mortgage loans more than eight percentage points above the yield on U.S. Treasury securities having a comparable maturity,
- interest rates for subordinate lien mortgage loans more than 10 percentage points above the yield on U.S. Treasury securities having a comparable maturity, or
- total points and fees paid in the credit transaction exceed the greater of either 8% of the loan amount or a specified dollar amount that is inflation-adjusted each year.

The Home Ownership and Equity Protection Act prohibits or restricts numerous credit practices, including loan flipping by the same lender or loan servicer within a year of the residential mortgage loan being refinanced. Lenders are presumed to have violated the law unless they document that the borrower has the ability to repay. Lenders violating the rules face cancellation of loans and penalties equal to the finance charges paid. The Home Ownership and Equity Protection Act also governs so-called "reverse mortgages." For mortgages that are defined as "higher-priced mortgages," rules issued under the Home Ownership and Equity Protection Act require disclosures and additional protections and prohibit specified practices. The rules define "higher-priced mortgages" as closed-end mortgage loans that are secured by a consumer's principal dwelling and that have an annual percentage rate exceeding – by at least 1.5 percentage points for first-lien loans or 3.5 percentage points for subordinate-lien loans – the average prime offer rates for a comparable transaction published by the Federal Reserve Board. The Federal Reserve derives average prime offer rates from the Freddie Mac Primary Mortgage Market Survey. For higher-priced mortgage loans, the final rules –

- prohibit creditors from extending credit without regard to a consumer's ability to repay from sources other than the collateral itself,
- require creditors to verify income and assets relied upon to determine repayment ability,
- prohibit prepayment penalties except under certain conditions, and

- require creditors to establish escrow accounts for taxes and insurance in the case of first-lien higher-priced mortgage loans, but permit creditors to allow borrowers to cancel escrows 12 months after loan consummation.

State Banking Regulation As Ohio-chartered banks, the banks are subject to regular examination by the Ohio Division of Financial Institutions. State banking regulation affects the internal organization of the banks as well as their savings, lending, investment, and other activities. State banking regulation may contain limitations on an institution's activities that are in addition to limitations imposed under federal banking law. The Ohio Division of Financial Institutions may initiate supervisory measures or formal enforcement actions, and if the grounds provided by law exist it may take possession and control of an Ohio-chartered bank.

Monetary Policy The earnings of financial institutions are affected by the policies of regulatory authorities, including monetary policy of the Federal Reserve Board. An important function of the Federal Reserve System is regulation of aggregate national credit and money supply. The Federal Reserve Board accomplishes these goals with measures such as open market transactions in securities, establishment of the discount rate on bank borrowings, and changes in reserve requirements against bank deposits. These methods are used in varying combinations to influence overall growth and distribution of financial institutions' loans, investments and deposits, and they also affect interest rates charged on loans or paid on deposits. Monetary policy is influenced by many factors, including inflation, unemployment, short-term and long-term changes in the international trade balance, and fiscal policies of the United States government. Federal Reserve Board monetary policy has had a significant effect on the operating results of financial institutions in the past, and it can be expected to influence operating results in the future.

Item 1.A — Risk Factors

Risks Related to the Company's Business

Continued negative developments in the financial industry and the domestic credit market may adversely affect the Company's operations and results. Negative developments starting in the latter half of 2007 and continuing through 2012 in the credit and securitization markets have resulted in uncertainty in financial markets with the expectation of the general economic sluggishness continuing in 2013. Business activity across a wide range of industries and regions is declining. Unemployment has been persistently high. During 2012 the financial services industry was materially and adversely affected by the continued reduced values of nearly all asset classes. These negative developments were initially triggered by declines in home prices and the values of subprime residential mortgage loans, but quickly spread to other asset classes. Market conditions have also led to the failure or merger of a number of formerly prominent and large financial institutions. More than 450 financial institutions had failed in the five-year period from January 1, 2008 through December 31, 2012. Furthermore, declining asset values on financial instruments, defaults on residential mortgages and consumer loans, and the lack of market and investor confidence, as well as other factors, have all combined to decrease liquidity, despite very significant declines in Federal Reserve borrowing rates and other government actions. Some banks and other lenders have suffered significant losses and have become reluctant to lend, even on a secured basis, due to the increased risk of default and the impact of declining asset values on the value of collateral. If current levels of market disruption and volatility continue or worsen, there can be no assurance that the Company will not experience an adverse effect, which may be material, on our ability to access capital and on our business, financial condition, and results of operations.

The Company operates in a highly competitive industry and market area. The U.S. financial system has become highly concentrated and has moved into a barbell-type structure. This structure is characterized at one end by a handful of large financial conglomerates controlling a disproportionate share of deposits and industry assets, with thousands of community financial institutions spread across the U.S at the other end controlling the remainder of deposits and industry assets. While the nation's largest banks have not been permitted to fail, community banks do fail with regularity. This policy disparity has entrenched an ongoing competitive inequity against community banks.

The Company faces significant competition both in making loans and in attracting deposits. Competition is based on interest rates and other credit and service charges, the quality of services rendered, the convenience of banking facilities, the range and type of products offered and, in the case of loans to larger commercial borrowers, lending limits, among other factors. Competition for loans comes principally from commercial banks, savings banks, savings and loan associations, credit unions, mortgage banking companies, insurance companies, and other financial service companies. The Company's most direct competition for deposits has historically come from commercial banks, savings banks, and savings and loan associations. Technology has also lowered barriers to entry and made it possible for non-

banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Larger competitors may be able to achieve economies of scale and, as a result, offer a broader range of products and services. The Company's ability to compete successfully depends on a number of factors, including, among other things:

- the ability to develop, maintain, and build long-term customer relationships based on top quality service, high ethical standards, and safe, sound assets;
- the ability to expand the Company's market position;
- the scope, relevance, and pricing of products and services offered to meet customer needs and demands;
- the rate at which the Company introduces new products and services relative to its competitors;
- customer satisfaction with the Company's level of service; and
- industry and general economic trends.

Failure to perform in any of these areas could significantly weaken the Company's competitive position, which could adversely affect growth and profitability.

The Company may not be able to attract and retain skilled people. The Company's success depends, in large part, on its ability to attract and retain key people. Competition for the best people can be intense and the Company may not be able to hire people or to retain them. The unexpected loss of the services of key personnel of the Company could have a material adverse impact on the Company's business because of their skills, knowledge of the Company's market, years of industry experience, and the difficulty of promptly finding qualified replacement personnel. The Company does not currently have employment agreements or non-competition agreements with any of its senior officers.

The Company does not have the financial and other resources that larger competitors have; this could affect its ability to compete for large commercial loan originations and its ability to offer products and services competitors provide to customers. The northeastern Ohio and central Ohio markets in which the Company operates have high concentrations of financial institutions. Many of the financial institutions operating in our markets are branches of significantly larger institutions headquartered in Cleveland or in other major metropolitan areas, with significantly greater financial resources and higher lending limits. In addition, many of these institutions offer services that the Company does not or cannot provide. For example, the larger competitors' greater resources offer advantages such as the ability to price services at lower, more attractive levels, and the ability to provide larger credit facilities. Because the Company is currently smaller than many commercial lenders in its market, it is on occasion prevented from making commercial loans in amounts competitors can offer. The Company accommodates loan volumes in excess of its lending limits from time to time through the sale of loan participations to other banks.

The business of banking is changing rapidly with changes in technology, which poses financial and technological challenges to small and mid-sized institutions. With frequent introductions of new technology-driven products and services, the banking industry is undergoing rapid technological changes. In addition to enhancing customer service, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Financial institutions' success is increasingly dependent upon use of technology to provide products and services that satisfy customer demands and to create additional operating efficiencies. Many of the Company's competitors have substantially greater resources to invest in technological improvements, which could enable them to perform various banking functions at lower costs than the Company, or to provide products and services that the Company is not able to economically provide. The Company cannot assure you that we will be able to develop and implement new technology-driven products or services or that the Company will be successful in marketing these products or services to customers. Because of the demand for technology-driven products, banks increasingly rely on unaffiliated vendors to provide data processing services and other core banking functions. The use of technology-related products, services, delivery channels, and processes exposes banks to various risks, particularly transaction, strategic, reputation, and compliance risk. The Company cannot assure you that we will be able to successfully manage the risks associated with our dependence on technology.

The banking industry is heavily regulated; the compliance burden to the industry is considerable; the principal beneficiary of federal and state regulation is the public at large and depositors, not stockholders. The Company and its subsidiaries are and will remain subject to extensive state and federal government supervision and regulation. This supervision and regulation affects many aspects of the banking business, including permissible activities, lending, investments, payment of dividends, the geographic locations in which our services can be offered, and numerous other matters. State and federal supervision and regulation are intended principally to protect depositors, the public, and the deposit insurance fund administered by the FDIC. Protection of stockholders is not a goal of banking regulation.

The burdens of federal and state banking regulation place banks in general at a competitive disadvantage compared to less regulated competitors. Applicable statutes, regulations, agency and court interpretations, and agency enforcement policies have undergone significant changes, and could change significantly again. Federal and state banking agencies also require banks and bank holding companies to maintain adequate capital. Failure to maintain adequate capital or to comply with applicable laws, regulations, and supervisory agreements could subject a bank or bank holding company to federal or state enforcement actions, including termination of deposit insurance, imposition of fines and civil penalties, and, in the most severe cases, appointment of a conservator or receiver for a depository institution. Changes in applicable laws and regulatory policies could adversely affect the banking industry generally or the Company in particular. The Company gives you no assurance that we will be able to adapt successfully to industry changes caused by governmental actions.

Success in the banking industry requires disciplined management of lending risks. There are many risks in the business of lending, including risks associated with the duration over which loans may be repaid, risks resulting from changes in economic conditions, risks inherent in dealing with individual borrowers, and risks resulting from changes in the value of loan collateral. We attempt to mitigate this risk by a thorough review of the creditworthiness of loan customers. Nevertheless, there is risk that our credit evaluations will prove to be inaccurate due to changed circumstances or otherwise.

A critical resource for maintaining the safety and soundness of banks so that they can fulfill their basic function of financial intermediation, the allowance for possible loan losses is a reserve established through a provision for possible loan losses charged to expense that represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. Current accounting standards for loan loss provisioning are based on the so-called "incurred loss" model. Under this model, a bank can reserve against a loan loss through a provision to the loan loss reserve only if that loss has been "incurred," which means a loss that is probable and can be reasonably estimated. To meet that standard, banks have to document why a loss is probable and reasonably estimable, and the easiest way to do that is to refer to historical loss rates and the bank's own prior loss experience with the type of asset in question. Banks are not limited to using historical experience in deciding the appropriate level of the loan loss reserve. In making these determinations, management can use judgment that takes into account other, forward-leaning factors, such as changes in underwriting standards and changes in the economic environment that would have an impact on loan losses. It is changes in the current economic environment that have led us, and may continue to lead management, to take provisions that are higher than our historical experience.

The level of the allowance reflects management's continuing evaluation of industry concentrations; specific credit risks; loan loss experience; current loan portfolio quality; present economic, political, and regulatory conditions; and unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for possible loan losses inherently involves a high degree of subjectivity and requires management to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Continuing deterioration in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of the Company's control, may require an increase in the allowance for possible loan losses. In addition, bank regulatory agencies periodically review the allowance for loan losses and may require an increase in the provision for possible loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance for possible loan losses, the Company will need additional provisions to increase the allowance for possible loan losses. Any increases in the allowance for possible loan losses will result in a decrease in net income and, possibly, capital, and may have a material adverse effect on the Company's financial condition and results of operations.

Material breaches in security of bank systems may have a significant effect on the Company business. The company's two subsidiary banks collect, process and store sensitive consumer data by utilizing computer systems and telecommunications networks operated by both banks and third party service providers. The two banks have security, backup and recovery systems in place, as well as a business continuity plan to ensure the banks' systems will not be

inoperable. The company's two subsidiary banks also have security to prevent unauthorized access to the system. In addition, the banks require third party service providers to maintain similar controls. However, the subsidiary banks cannot be certain that these measures will be successful. A security breach in the system and loss of confidential information could result in losing customers' confidence and thus the loss of their business as well as additional significant costs for privacy monitoring activities.

The banks' necessary dependence upon automated systems to record and process the banks' transaction volumes poses the risk that technical system flaws or employee errors, tampering or manipulation of those systems will result in losses and may be difficult to detect. The company's two subsidiary banks may also be subject to disruptions of the operating systems arising from events that are beyond either bank's control (for example, computer viruses or electrical or telecommunications outages). The banks are further exposed to the risk that the third party service providers may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors as the banks). These disruptions may interfere with service to the banks' customers and result in a financial loss or liability.

Changing interest rates have a direct and immediate impact on financial institutions. The risk of nonpayment of loans — or credit risk — is not the only lending risk. Lenders are subject also to interest rate risk. Fluctuating rates of interest prevailing in the market affect a bank's net interest income, which is the difference between interest earned from loans and investments, on one hand, and interest paid on deposits and borrowings, on the other. Changes in the general level of interest rates can affect our net interest income by affecting the difference between the weighted average yield earned on our interest-earning assets and the weighted average rate paid on our interest-bearing liabilities, or interest rate spread, and the average life of our interest-earning assets and interest-bearing liabilities. Changes in interest rates also can affect (i) our ability to originate loans, (ii) the value of our interest-earning assets, and our ability to realize gains from the sale of such assets, (iii) our ability to obtain and retain deposits in competition with other available investment alternatives, and (iv) the ability of our borrowers to repay adjustable or variable rate loans. Interest rates are highly sensitive to many factors, including governmental monetary policies, domestic and international economic and political conditions, and other factors beyond our control. Although the Company believes that the estimated maturities of our interest-earning assets currently are well balanced in relation to the estimated maturities of our interest-bearing liabilities (which involves various estimates as to how changes in the general level of interest rates will impact these assets and liabilities), there can be no assurance that our profitability would not be adversely affected during any period of changes in interest rates.

A prolonged economic downturn in our market area would adversely affect our loan portfolio and our growth prospects. Our lending market area is concentrated in northeastern and central Ohio, particularly Franklin, Geauga, Portage, Trumbull, and Ashtabula Counties. A very significant percentage of our loan portfolio is secured by real estate collateral, primarily residential mortgage loans. Commercial and industrial loans to small and medium-sized businesses also represent a significant percentage of our loan portfolio. The asset quality of our loan portfolio is largely dependent upon the area's economy and real estate markets. A prolonged economic downturn would likely contribute to the deterioration of the credit quality of our loan portfolio and reduce our level of customer deposits, which in turn would hurt our business. If the current economic stagnation continues for a prolonged period, borrowers may be less likely to repay their loans as scheduled or at all. Moreover, the value of real estate or other collateral that may secure our loans could be adversely affected. Unlike many larger institutions, we are not able to spread the risks of unfavorable local economic conditions across a large number of diversified economies and geographic locations. A prolonged economic downturn could, therefore, result in losses that could materially and adversely affect our business.

The Company could incur liabilities under federal and state environmental laws if we foreclose on commercial properties. A high percentage of the Company's loans are secured by real estate. Although the vast majority of these loans are residential mortgage loans with little associated environmental risk, some are commercial loans secured by property on which manufacturing and other commercial enterprises are carried on. The Company has in the past and could again acquire property by foreclosing on loans in default. Under federal and state environmental laws, a bank could face liability for some or all of the costs of removing hazardous substances, contaminants, or pollutants from properties acquired in this fashion. Although other persons might be primarily responsible for these costs, these persons might not be financially solvent or they might be unable to bear the full cost of clean-up. It is also possible that a lender exercising unusual influence over a borrower's commercial activities could be required to bear a portion of the clean-up costs under federal or state environmental laws.

Changes in accounting standards could materially impact our consolidated financial statements. Our accounting policies and methods are fundamental to how the Company records and reports its financial condition and results of operations. The accounting standard setters, including the Financial Accounting Standards Board, the SEC, and other

regulatory bodies, from time to time may change the financial accounting and reporting standards that govern the preparation of our consolidated financial statements. These changes can be hard to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, the Company could be required to apply a new or revised standard retroactively, resulting in changes to previously reported financial results, or a cumulative charge to retained earnings. Management may be required to make difficult, subjective, or complex judgments about matters that are uncertain. Materially different amounts could be reported under different conditions or using different assumptions.

There are risks with respect to future expansion and acquisitions or mergers. The Company may seek in the future to acquire other financial institutions or parts of those institutions. The Company may also expand into new markets or lines of business or offer new products or services. These activities would involve a number of risks, including—

- the time and expense associated with identifying and evaluating potential acquisitions and merger partners;
- using inaccurate estimates and judgments to evaluate credit, operations, management, and market risks with respect to the target institution or assets;
- diluting our existing shareholders in an acquisition;
- the time and expense associated with evaluating new markets for expansion, hiring experienced local management, and opening new offices;
- taking a significant amount of time negotiating a transaction or working on expansion plans, resulting in management's attention being diverted from the operation of our existing business; and
- the time and expense associated with integrating the operations and personnel of the combined businesses, creating an adverse short-term effect on our results of operations.

There is also a risk that any expansion effort will not be successful.

Compliance with Sarbanes-Oxley Act and the Dodd-Frank Act involves significant expenditures, and non-compliance may adversely affect us. The Sarbanes-Oxley Act of 2002 ("SOX"), the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2011 (the "Dodd-Frank Act"), and the related rules and regulations promulgated by the SEC and the bank regulatory agencies that are now applicable to us have increased the scope, complexity, and cost of corporate governance, reporting, disclosure, and routine banking practices. The Company expects to experience greater compliance costs, including those related to internal controls. We expect the applicability of these rules and regulations to us will continue to increase our accounting, legal, and other costs, and to make some activities more difficult, time consuming, and costly to implement. In the event that the Company is unable to maintain or achieve compliance with SOX, the Dodd-Frank Act, and any related rules, it may be adversely affected.

The Company utilizes the Federal Home Loan Bank as an additional source of liquidity. The Middlefield Banking Company and Emerald Bank are members of the Federal Home Loan Bank ("FHLB") of Cincinnati, which is one of the twelve regional banks comprising the FHLB System. The FHLB provides credit for member financial institutions. As a member of the FHLB, the Company is required to own stock in the FHLB in proportion to our borrowings. The Company is authorized to apply for advances from the FHLB, which are collateralized in the aggregate by loans, securities, FHLB stock, and by deposits with the FHLB. FHLB advances are only available to borrowers that meet certain conditions. If the Company were to cease meeting these conditions, our access to FHLB advances could be significantly reduced or eliminated.

The 12 FHLBs obtain their funding primarily through issuance of consolidated obligations of the FHLB System. The U.S. government does not guarantee these obligations, and each of the 12 FHLBs are jointly and severally liable for repayment of each other's debt. Therefore, the Company's investment in the equity stock of the FHLB of Cincinnati could be adversely impacted by the operations of the other FHLBs. Certain FHLBs, including Cincinnati, have experienced lower earnings from time to time and paid out lower dividends to their members. If a FHLB's capital drops below 4% of its assets, restrictions on the redemption or repurchase of member banks' FHLB stock are imposed by law. Should the FHLBs be restricted from redeeming or repurchasing member banks' FHLB stock due to adverse

financial conditions affecting either individual FHLBs or the FHLB System as a whole, member banks may be required to recognize an impairment charge on their FHLB equity stock investments. Future problems at the FHLBs may impact the collateral necessary to secure borrowings and limit the borrowings extended to member banks, as well as require additional capital contributions by member banks. Should this occur, the Company's short term liquidity needs could be negatively impacted. Should the Company be restricted from using FHLB advances due to weakness in the FHLB System or with the FHLB of Cincinnati, the Company may be forced to find alternative funding sources. These alternative funding sources may include seeking lines of credit with third party banks or the Federal Reserve Bank, borrowing under repurchase agreement lines, increasing deposit rates to attract additional funds, accessing brokered deposits, or selling certain investment securities categorized as available-for-sale in order to maintain adequate levels of liquidity.

Government regulation could restrict our ability to pay cash dividends. Dividends from the banks are the only significant source of cash for the Company. Statutory and regulatory limits could prevent the banks from paying dividends or transferring funds to the Company. As of December 31, 2012, MBC could have declared dividends of approximately \$8.1 million in the aggregate to Company without having to obtain advance regulatory approval. The Company cannot assure you that the Banks' profitability will continue to allow dividends to the Company, and the Company therefore cannot assure you that the Company will be able to continue paying regular, quarterly cash dividends. EB may not pay dividends to the Company unless EB first gives notice to the FDIC and the Ohio Division of Financial Institutions. The Company anticipates that for the foreseeable future, EB will not pay dividends to the Company but will instead retain earnings, if any, for the purpose of maintaining capital.

Risks Associated with the Company's Common Stock

An investment in the Company's common stock is not an insured deposit. The Company's common stock is not a bank deposit and, therefore, is not insured against loss by the Federal Deposit Insurance Corporation (FDIC), any other deposit insurance fund or by any other public or private entity. As a result, if you acquire the Company's common stock, you could lose some or all of your investment.

The Company's common stock is very thinly traded, and it is therefore susceptible to wide price swings. The Company's common stock is not traded or authorized for quotation on any exchanges, including Nasdaq. However, bid prices for Company common stock appear from time to time in the OTCQB under the symbol "MBCN." OTCQB is for domestic (U.S.) companies registered with and reporting to the Securities and Exchange Commission or a banking or insurance regulator. Thinly traded, illiquid stocks are more susceptible to significant and sudden price changes than stocks that are widely followed by the investment community and actively traded on an exchange. The liquidity of the Company's common stock depends upon the presence in the marketplace of willing buyers and sellers. The Company cannot assure you that you will be able to find a buyer for your shares. Several broker dealers facilitate trades of the company common stock, matching interested buyers and sellers. The Company currently does not intend to seek listing of the Company's common stock on Nasdaq or on another securities exchange. Even if we successfully list the Company's common stock on a securities exchange, the Company nevertheless could not assure you that an organized public market for the securities will develop or that there will be any private demand for the Company's common stock. The Company could also fail subsequently to satisfy the standards for continued exchange listing, such as standards having to do with the minimum number of public shareholders or the aggregate market value of publicly held shares. A stock that is not listed on a securities exchange might not be accepted as collateral for loans. If accepted as collateral, the stock's value could nevertheless be substantially discounted. Consequently, investors should regard the Company's common stock as a long-term investment and should be prepared to bear the economic risk for an indefinite period. Investors who need or desire to dispose of all or a part of their investments in the Company's common stock might not be able to do so except by private, direct negotiations with third parties.

Item 1B — Unresolved Staff Comments

Not applicable

Item 2 — Properties

The Company's offices are:

<u>Location</u>	<u>County</u>	<u>Owned/Leased</u>	<u>Other Information</u>
Main Office: 15985 East High Street Middlefield, Ohio	Geauga	Owned	
Branches : West Branch 15545 West High Street Middlefield, Ohio	Geauga	Owned	
Garrettsville Branch 8058 State Street Garrettsville, Ohio	Portage	Owned	
Mantua Branch 10519 South Main Street Mantua, Ohio	Portage	Leased	three-year lease renewed in November 2010, with option to renew for five additional consecutive three-year terms
Chardon Branch 348 Center Street Chardon, Ohio	Geauga	Owned	
Orwell Branch 30 South Maple Avenue Orwell, Ohio	Ashtabula	Owned	
Newbury Branch 11110 Kinsman Road Newbury, Ohio	Geauga	Leased	ten-year lease dated December 2006, with option to renew for four additional consecutive five-year terms
Cortland Branch 3450 Niles Cortland Road Cortland, Ohio	Trumbull	Owned	
Emerald Bank 6215 Perimeter Drive Dublin, OH	Franklin	Leased	twenty-year lease dated February 2004, with the option to purchase after the tenth year
Westerville Branch (Emerald Bank) 17 North State Street Westerville, OH	Franklin	Owned	
Administrative Offices: 15200 Madison Road Suite 108 Middlefield, Ohio 44062	Geauga	Leased	five-year lease dated March 2012

At December 31, 2012 the net book value of the Company's investment in premises and equipment totaled \$8.7 million.

Item 3 — Legal Proceedings

From time to time the Company and the banks are involved in various legal proceedings that are incidental to its business. In the opinion of management, no current legal proceedings are material to the financial condition of Company or the Banks, either individually or in the aggregate.

Item 4 — Mine Safety Disclosures

Not applicable

Part II

Item 5 — Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Information relating to the market for Middlefield's common equity and related shareholder matters appears under "Market Price of and Dividends on the Registrant's Common Equity and Related Stockholder Matters" in the Company's 2012 Annual Report to Shareholders and is incorporated herein by reference. Information relating to dividend restrictions for Registrant's common stock appears under "Supervision and Regulation."

Equity Compensation Plan information

The following table provides information as of December 31, 2012 with respect to shares of common stock that may be issued under the Company's existing equity plans.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options or Rights	Weighted- Average Exercise Price of Outstanding Options or Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column A)
Equity compensation plans approved by security holders:			
1999 Stock Option Plan	49,318	\$ 30.85	-
2007 Omnibus Equity Plan	30,375	21.41	80,307
Total	79,693	\$ 27.25	80,307

Unregistered Sales of Equity Securities and Use of Proceeds

In a private common stock offering that began in 2010, Middlefield Banc Corp. sold a total of 138,150 shares in 2011, followed by a sale of 93,050 shares on April 17, 2012 and a sale of 103,585 shares on April 30, 2012. The offering concluded on March 8, 2013 with a sale of 13,320 shares to an institutional investor, completing the sale to that investor under the terms of the subscription agreement it entered into in August of 2011. All sales in the offering occurred at \$16 per share. In reliance on the private offering exemption in the SEC's Regulation D, Rule 506, the offering was carried out without registration under the Securities Act of 1933. We made offers and sales solely to those qualifying as accredited investors, as defined in Regulation D.

For additional information, interested persons should refer to the reports that we filed with the SEC concerning the private offering, including exhibits to those reports, specifically the following –

1. the Form 8-K Current Report that we filed with the SEC on August 18, 2011,
2. the August 15, 2011 Stock Purchase Agreement between Middlefield Banc Corp. and Banc Opportunity Fund LLC (exhibit 10.26 to the Form 8-K Current Report filed on August 18, 2011),
3. the First, Second, Third, and Fourth Amendments of the Stock Purchase Agreement (exhibits 10.26.1, 10.26.2, 10.26.3, and 10.26.4 to our Form 10-K Annual Report for the year ended December 31, 2011),
4. the Form 8-K Current Report that we filed with the SEC on March 27, 2012,
5. the Form 8-K Current Report that we filed with the SEC on April 23, 2012,
6. the Fifth Amendment of the Stock Purchase Agreement and the Amended and Restated Purchaser's Rights and Voting Agreement (exhibits 10.26.6 and 10.28 to the Form 8-K Current Report filed on April 23, 2012),
7. the Form 8-K Current Report that we filed with the SEC on May 4, 2012,
8. the Form 8-K Current Report that we filed with the SEC on August 7, 2012,
9. the Form 8-K Current Report that we filed with the SEC on August 24, 2012,
10. the Sixth Amendment of the Stock Purchase Agreement and the Amendment of the Amended and Restated Purchaser's Rights and Voting Agreement (exhibits 10.26.7 and 10.28.1 to the Form 8-K Current Report filed on August 24, 2012),
11. Note 7, captioned "Common Stock Issuance," of the Notes to Unaudited Consolidated Financial Statements included in our Form 10-Q Quarterly Report for the quarter ended September 30, 2012, filed with the SEC on November 8, 2012, and
12. the Form 8-K Current Report that we filed with the SEC on January 18, 2013.
13. Note 18, captioned "Common Stock Offering," of the Notes to Consolidated Financial Statements accompanying the Consolidated Financial Statements of the Company and subsidiaries as of and for the year ended December 31, 2012, included in the 2012 Annual Report to Shareholders and incorporated herein by reference.

Item 6 — Selected Financial Data

Not applicable.

Item 7 — Management's Discussion and Analysis of Financial Condition and Results of Operations

The above-captioned information appears under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's 2012 Annual Report to Shareholders and is incorporated herein by reference.

Item 7A — Quantitative and Qualitative Disclosures About Market Risk

The above-captioned information appears under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the section "*Interest Rate Sensitivity Simulation Analysis*" in the Company's 2012 Annual Report to Shareholders and is incorporated herein by reference.

Item 8 — Financial Statements and Supplementary Data

The Consolidated Financial Statements of the Company and its subsidiaries, together with the report thereon by S.R. Snodgrass, A.C. appear in the Company's 2012 Annual Report to Shareholders and are incorporated herein by reference.

Item 9 — Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

Item 9A – Controls and Procedures

(a) Disclosure Controls and Procedures

The Company's management, including the Company's principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the "Exchange Act"). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (the "SEC") (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

(b) Internal Controls Over Financial Reporting

Management's annual report on internal control over financial reporting is incorporated herein by reference to Item 8 - the Company's audited Consolidated Financial Statements in this Annual Report on Form 10-K.

(c) Changes to Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the three months ended December 31, 2012 that have materially affected, or are reasonable likely to materially affect, the Company's internal control over financial reporting.

Item 9b — Other Information

None

Part III

Item 10 — Directors, Executive Officers of the Registrant, and Corporate Governance

Incorporated by reference to the definitive proxy statement for the 2013 annual meeting of shareholders, which will be filed with the Securities and Exchange Commission not later than 120 days after December 31, 2012.

Item 11 — Executive Compensation

Incorporated by reference to the definitive proxy statement for the 2013 annual meeting of shareholders, which will be filed with the Securities and Exchange Commission not later than 120 days after December 31, 2012.

Item 12 — Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Incorporated by reference to the definitive proxy statement for the 2013 annual meeting of shareholders, which will be filed with the Securities and Exchange Commission not later than 120 days after December 31, 2012. The information required by this item concerning Equity Compensation Plan information is presented under the caption "EQUITY COMPENSATION PLAN INFORMATION" contained in Part II, Item 5. "Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities".

Item 13 — Certain Relationships, Related Transactions, and Director Independence

Incorporated by reference to the definitive proxy statement for the 2013 annual meeting of shareholders, which will be filed with the Securities and Exchange Commission not later than 120 days after December 31, 2012.

Item 14 — Principal Accountant Fees and Services

Incorporated by reference to the definitive proxy statement for the 2013 annual meeting of shareholders, which will be filed with the Securities and Exchange Commission not later than 120 days after December 31, 2012.

PART IV

Item 15 — Exhibits, Financial Statement Schedules

(a)(1) Financial Statements

Index to Consolidated Financial Statements :

Consolidated Financial Statements as of December 31, 2012 and 2011 and for each of the three years in the period ended December 31, 2012:

Report of Independent Registered Public Accounting firm

Consolidated Balance Sheets

Consolidated Statements of Income

Consolidated Statements of Changes in Stockholders' Equity

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

(a)(2) Financial Statement Schedules

Financial Statement Schedules have been omitted because they are not applicable or the required information is shown elsewhere in the document in the Financial Statements or Notes thereto, or in "Management's Discussion and Analysis of Financial Condition and Results of Operations."

(a)(3) Exhibits

See the list of exhibits below

(b) Exhibits Required by Item 601 of Regulation S-K

exhibit number	description	location
3.1	Second Amended and Restated Articles of Incorporation of Middlefield Banc Corp., as amended	Incorporated by reference to Exhibit 3.1 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Fiscal Year Ended December 31, 2005, filed on March 29, 2006
3.2	Regulations of Middlefield Banc Corp.	Incorporated by reference to Exhibit 3.2 of Middlefield Banc Corp.'s registration statement on Form 10 filed on April 17, 2001
4.0	Specimen stock certificate	Incorporated by reference to Exhibit 4 of Middlefield Banc Corp.'s registration statement on Form 10 filed on April 17, 2001
4.1	Amended and Restated Trust Agreement, dated as of December 21, 2006, between Middlefield Banc Corp., as Depositor, Wilmington Trust Company, as Property trustee, Wilmington Trust Company, as Delaware Trustee, and Administrative Trustees	Incorporated by reference to Exhibit 4.1 of Middlefield Banc Corp.'s Form 8-K Current Report filed on December 27, 2006
4.2	Junior Subordinated Indenture, dated as of December 21, 2006, between Middlefield Banc Corp. and Wilmington Trust Company	Incorporated by reference to Exhibit 4.2 of Middlefield Banc Corp.'s Form 8-K Current Report filed on December 27, 2006
4.3	Guarantee Agreement, dated as of December 21, 2006, between Middlefield Banc Corp. and Wilmington Trust Company	Incorporated by reference to Exhibit 4.3 of Middlefield Banc Corp.'s Form 8-K Current Report filed on December 27, 2006
10.1.0*	1999 Stock Option Plan of Middlefield Banc Corp.	Incorporated by reference to Exhibit 10.1 of Middlefield Banc Corp.'s registration statement on Form 10 filed on April 17, 2001
10.1.1*	2007 Omnibus Equity Plan	Incorporated by reference to Middlefield Banc Corp.'s definitive proxy statement for the 2008 Annual Meeting of Shareholders, Appendix A, filed on April 7, 2008
10.2*	Severance Agreement between Middlefield Banc Corp. and Thomas G. Caldwell, dated January 7, 2008	Incorporated by reference to Exhibit 10.2 of Middlefield Banc Corp.'s Form 8-K Current Report filed on January 9, 2008
10.3*	Severance Agreement between Middlefield Banc Corp. and James R. Heslop, II, dated January 7, 2008	Incorporated by reference to Exhibit 10.3 of Middlefield Banc Corp.'s Form 8-K Current Report filed on January 9, 2008
10.4.0*	Severance Agreement between Middlefield Banc Corp. and Jay P. Giles, dated January 7, 2008	Incorporated by reference to Exhibit 10.4 of Middlefield Banc Corp.'s Form 8-K Current Report filed on January 9, 2008
10.4.1*	Severance Agreement between Middlefield Banc Corp. and Teresa M. Hetrick, dated January 7, 2008	Incorporated by reference to Exhibit 10.4.1 of Middlefield Banc Corp.'s Form 8-K Current Report filed on January 9, 2008
10.4.2	[reserved]	
10.4.3*	Severance Agreement between Middlefield Banc Corp. and Donald L. Stacy, dated January 7, 2008	Incorporated by reference to Exhibit 10.4.3 of Middlefield Banc Corp.'s Form 8-K Current Report filed on January 9, 2008
10.4.4*	Severance Agreement between Middlefield Banc Corp. and Alfred F. Thompson Jr., dated January 7, 2008	Incorporated by reference to Exhibit 10.4.4 of Middlefield Banc Corp.'s Form 8-K Current Report filed on January 9, 2008

exhibit number	description	location
10.5	Federal Home Loan Bank of Cincinnati Agreement for Advances and Security Agreement dated September 14, 2000	Incorporated by reference to Exhibit 10.4 of Middlefield Banc Corp.'s registration statement on Form 10 filed on April 17, 2001
10.6*	Amended Director Retirement Agreement with Richard T. Coyne	Incorporated by reference to Exhibit 10.6 of Middlefield Banc Corp.'s Form 8-K Current Report filed on January 9, 2008
10.7*	Amended Director Retirement Agreement with Frances H. Frank	Incorporated by reference to Exhibit 10.7 of Middlefield Banc Corp.'s Form 8-K Current Report filed on January 9, 2008
10.8*	Amended Director Retirement Agreement with Thomas C. Halstead	Incorporated by reference to Exhibit 10.8 of Middlefield Banc Corp.'s Form 8-K Current Report filed on January 9, 2008
10.9*	Director Retirement Agreement with George F. Hasman	Incorporated by reference to Exhibit 10.9 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2001, filed on March 28, 2002
10.10*	Director Retirement Agreement with Donald D. Hunter	Incorporated by reference to Exhibit 10.10 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2001, filed on March 28, 2002
10.11*	Director Retirement Agreement with Martin S. Paul	Incorporated by reference to Exhibit 10.11 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2001, filed on March 28, 2002
10.12*	Amended Director Retirement Agreement with Donald E. Villers	Incorporated by reference to Exhibit 10.12 of Middlefield Banc Corp.'s Form 8-K Current Report filed on January 9, 2008
10.13*	Executive Survivor Income Agreement (aka DBO agreement [death benefit only]) with Donald L. Stacy	Incorporated by reference to Exhibit 10.14 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2003, filed on March 30, 2004
10.14*	DBO Agreement with Jay P. Giles	Incorporated by reference to Exhibit 10.15 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2003, filed on March 30, 2004
10.15*	DBO Agreement with Alfred F. Thompson Jr.	Incorporated by reference to Exhibit 10.16 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2003, filed on March 30, 2004
10.16	[reserved]	
10.17*	DBO Agreement with Theresa M. Hetrick	Incorporated by reference to Exhibit 10.18 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2003, filed on March 30, 2004
10.18 *	Executive Deferred Compensation Agreement with Jay P. Giles	Incorporated by reference to Exhibit 10.18 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2011, filed on March 20, 2012

exhibit number	description	location
10.19*	DBO Agreement with James R. Heslop, II	Incorporated by reference to Exhibit 10.20 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2003, filed on March 30, 2004
10.20*	DBO Agreement with Thomas G. Caldwell	Incorporated by reference to Exhibit 10.21 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2003, filed on March 30, 2004
10.21*	Form of Indemnification Agreement with directors of Middlefield Banc Corp. and with executive officers of Middlefield Banc Corp. and The Middlefield Banking Company	Incorporated by reference to Exhibit 99.1 of Middlefield Banc Corp.'s registration statement on Form 10, Amendment No. 1, filed on June 14, 2001
10.22*	Annual Incentive Plan Summary	Incorporated by reference to the summary description of the annual incentive plan included as Exhibit 10.22 of Middlefield Banc Corp.'s Form 8-K Current Report filed on December 16, 2005
10.23*	Amended Executive Deferred Compensation Agreement with Thomas G. Caldwell	Incorporated by reference to Exhibit 10.23 of Middlefield Banc Corp.'s Form 8-K Current Report filed on May 9, 2008
10.24*	Amended Executive Deferred Compensation Agreement with James R. Heslop, II	Incorporated by reference to Exhibit 10.24 of Middlefield Banc Corp.'s Form 8-K Current Report filed on May 9, 2008
10.25*	Amended Executive Deferred Compensation Agreement with Donald L. Stacy	Incorporated by reference to Exhibit 10.25 of Middlefield Banc Corp.'s Form 8-K Current Report filed on May 9, 2008
10.26*	Stock Purchase Agreement dated August 15, 2011 between Bank Opportunity Fund LLC and Middlefield Banc Corp.	Incorporated by reference to Exhibit 10.26 of Middlefield Banc Corp.'s Form 8-K Current Report filed on August 18, 2011
10.26.1	Amendment 1 of the Stock Purchase Agreement with Bank Opportunity Fund LLC (amendment dated September 29, 2011)	Incorporated by reference to Exhibit 10.26.1 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2011, filed on March 20, 2012
10.26.2	Amendment 2 of the Stock Purchase Agreement with Bank Opportunity Fund LLC (amendment dated October 20, 2011)	Incorporated by reference to Exhibit 10.26.2 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2011, filed on March 20, 2012
10.26.3	Amendment 3 of the Stock Purchase Agreement with Bank Opportunity Fund LLC (amendment dated November 28, 2011)	Incorporated by reference to Exhibit 10.26.3 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2011, filed on March 20, 2012
10.26.4	Amendment 4 of the Stock Purchase Agreement with Bank Opportunity Fund LLC (amendment dated December 21, 2011)	Incorporated by reference to Exhibit 10.26.4 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2011, filed on March 20, 2012
10.26.5	March 21, 2012 letter agreement between Bank Opportunity Fund LLC and Middlefield Banc Corp.	Incorporated by reference to Exhibit 10.26.5 of Middlefield Banc Corp.'s Form 8-K Current Report filed on March 27, 2012

exhibit number	description	location
10.26.6	Amendment 5 of the Stock Purchase Agreement with Bank Opportunity Fund LLC (amendment dated April 17, 2012)	Incorporated by reference to Exhibit 10.26.6 of Middlefield Banc Corp.'s Form 8-K Current Report filed on April 23, 2012
10.26.7	Amendment 6 of the Stock Purchase Agreement with Bank Opportunity Fund LLC (amendment dated August 23, 2012)	Incorporated by reference to Exhibit 10.26.7 of Middlefield Banc Corp.'s Form 8-K Current Report filed on August 24, 2012
10.27	[reserved]	
10.28	Amended and Restated Purchaser's Rights and Voting Agreement, dated April 17, 2012, among Bank Opportunity Fund LLC, Middlefield Banc Corp., and directors and officers of Middlefield Banc Corp..	Incorporated by reference to Exhibit 10.28 of Middlefield Banc Corp.'s Form 8-K Current Report filed on April 23, 2012
10.28.1	Amendment of the Amended and Restated Purchaser's Rights and Voting Agreement (amendment dated August 23, 2012)	Incorporated by reference to Exhibit 10.28.1 of Middlefield Banc Corp.'s Form 8-K Current Report filed on August 24, 2012
13	Portions of Annual Report to Shareholders for the year ended December 31, 2012 incorporated by reference into this Form 10-K	filed herewith
21	Subsidiaries of Middlefield Banc Corp.	filed herewith
23	Consent of S.R. Snodgrass, A.C., independent auditors of Middlefield Banc Corp.	filed herewith
31.1	Rule 13a-14(a) certification of Chief Executive Officer	filed herewith
31.2	Rule 13a-14(a) certification of Chief Financial Officer	filed herewith
32	Rule 13a-14(b) certification	filed herewith
101.INS**	XBRL Instance	furnished herewith
101.SCH**	XBRL Taxonomy Extension Schema	furnished herewith
101.CAL**	XBRL Taxonomy Extension Calculation	furnished herewith
101.DEF**	XBRL Taxonomy Extension Definition	furnished herewith
101.LAB**	XBRL Taxonomy Extension Labels	furnished herewith
101.PRE**	XBRL Taxonomy Extension Presentation	furnished herewith

* management contract or compensatory plan or arrangement

** XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Middlefield Banc Corp.

By: /s/ Thomas G. Caldwell
Thomas G. Caldwell
President and Chief Executive Officer
Date: March 13, 2013

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>/s/ Thomas G. Caldwell</u> Thomas G. Caldwell President, Chief Executive Officer, and Director	March 13, 2013
<u>/s/ Donald L. Stacy</u> Donald L. Stacy, Treasurer and Chief Financial Officer (Principal accounting and financial officer)	March 13, 2013
<u>/s/ Richard T. Coyne</u> Richard T. Coyne, Chairman of the Board	March 13, 2013
<u>/s/ Eric W. Hummel</u> Eric Hummel, Director	March 13, 2013
<u>/s/ James R. Heslop, II</u> James R. Heslop, II, Executive Vice President, Chief Operating Officer, and Director	March 13, 2013
<u>/s/ Kenneth E. Jones</u> Kenneth E Jones, Director	March 13, 2013
<u>/s/ James J. McCaskey</u> James J. McCaskey, Director	March 13, 2013
<u>/s/ Carolyn J. Turk</u> Carolyn J. Turk, Director	March 13, 2013
<u>/s/ William J. Skidmore</u> William J. Skidmore, Director	March 13, 2013
<u>/s/ Robert W. Toth</u> Robert W. Toth, Director	March 13, 2013

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
Middlefield Banc Corp.

We have audited the accompanying consolidated balance sheet of Middlefield Banc Corp. and subsidiaries (the "Company") as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the three years in the period ended December 31, 2012. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Middlefield Banc Corp. and subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the three years in the period ending December 31, 2012, in conformity with U.S. generally accepted accounting principles.

/s/ S.R. Snodgrass A.C.

S.R. Snodgrass A.C.
Wexford, Pennsylvania
March 13, 2013

MIDDLEFIELD BANC CORP.
CONSOLIDATED BALANCE SHEET
(Dollar amounts in thousands)

	December 31,	
	2012	2011
ASSETS		
Cash and due from banks	\$ 33,568	\$ 15,730
Federal funds sold	11,778	18,660
Cash and cash equivalents	45,346	34,390
Investment securities available for sale, at fair value	194,472	193,977
Loans	408,433	401,880
Less allowance for loan losses	7,779	6,819
Net loans	400,654	395,061
Premises and equipment, net	8,670	8,264
Goodwill	4,559	4,559
Core deposit intangibles	195	235
Bank-owned life insurance	8,536	8,257
Accrued interest and other assets	7,856	9,808
TOTAL ASSETS	\$ 670,288	\$ 654,551
LIABILITIES		
Deposits:		
Noninterest-bearing demand	\$ 75,912	\$ 63,348
Interest-bearing demand	63,915	55,853
Money market	81,349	75,621
Savings	175,406	167,207
Time	196,753	218,933
Total deposits	593,335	580,962
Short-term borrowings	6,538	7,392
Other borrowings	12,970	16,831
Accrued interest and other liabilities	2,008	2,113
TOTAL LIABILITIES	614,851	607,298
STOCKHOLDERS' EQUITY		
Common stock, no par value; 10,000,000 shares authorized, 2,181,763 and 1,951,868 shares issued	34,295	31,240
Retained earnings	22,485	18,206
Accumulated other comprehensive income	5,391	4,541
Treasury stock, at cost; 189,530 shares	(6,734)	(6,734)
TOTAL STOCKHOLDERS' EQUITY	55,437	47,253
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 670,288	\$ 654,551

See accompanying notes to the consolidated financial statements.

MIDDLEFIELD BANC CORP.
CONSOLIDATED STATEMENT OF INCOME
(Dollar amounts in thousands, except per share data)

	Year Ended December 31,		
	2012	2011	2010
INTEREST INCOME			
Interest and fees on loans	\$ 22,418	\$ 21,854	\$ 21,084
Interest-bearing deposits in other institutions	26	14	15
Federal funds sold	20	12	52
Investment securities:			
Taxable interest	3,209	4,862	5,185
Tax-exempt interest	2,976	2,883	2,650
Dividends on stock	97	102	108
Total interest income	<u>28,746</u>	<u>29,727</u>	<u>29,094</u>
INTEREST EXPENSE			
Deposits	5,728	7,467	9,504
Short-term borrowings	261	235	249
Other borrowings	294	400	642
Trust preferred securities	164	550	550
Total interest expense	<u>6,447</u>	<u>8,652</u>	<u>10,945</u>
NET INTEREST INCOME	22,299	21,075	18,149
Provision for loan losses	<u>2,168</u>	<u>3,085</u>	<u>3,580</u>
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	<u>20,131</u>	<u>17,990</u>	<u>14,569</u>
NONINTEREST INCOME			
Service charges on deposit accounts	1,765	1,512	1,784
Investment securities gains (losses), net	610	(173)	11
Earnings on bank-owned life insurance	279	278	273
Gains on sale of loans	85	-	-
Other income	712	620	555
Total noninterest income	<u>3,451</u>	<u>2,237</u>	<u>2,623</u>
NONINTEREST EXPENSE			
Salaries and employee benefits	7,127	7,233	6,411
Occupancy expense	959	953	946
Equipment expense	759	556	626
Data processing costs	772	693	743
Ohio state franchise tax	590	461	348
Federal deposit insurance expense	487	966	1,166
Professional fees	948	800	678
Losses on other real estate owned	258	497	783
Advertising expenses	423	439	401
Other real estate expenses	498	194	82
Other expense	2,818	2,709	2,579
Total noninterest expense	<u>15,639</u>	<u>15,501</u>	<u>14,763</u>
Income before income taxes	7,943	4,726	2,429
Income taxes (benefit)	<u>1,662</u>	<u>596</u>	<u>(88)</u>
NET INCOME	<u>\$ 6,281</u>	<u>\$ 4,130</u>	<u>\$ 2,517</u>
EARNINGS PER SHARE			
Basic	\$ 3.29	\$ 2.45	\$ 1.60
Diluted	3.28	2.45	1.60
DIVIDENDS DECLARED PER SHARE	\$ 1.04	\$ 1.04	\$ 1.04

See accompanying notes to the consolidated financial statements.

MIDDLEFIELD BANC CORP.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(Dollar amounts in thousands)

	Year Ended December 31,		
	2012	2011	2010
Net income	\$ 6,281	\$ 4,130	\$ 2,517
Other comprehensive income:			
Net unrealized holding gain (loss) on available for sale investment securities	1,897	5,969	(103)
Tax effect	(644)	(2,029)	35
Reclassification adjustment for investment security (gains) losses included in net income	(610)	173	(11)
Tax effect	207	(59)	4
Total other comprehensive income (loss)	850	4,054	(75)
Comprehensive income	<u>\$ 7,131</u>	<u>\$ 8,184</u>	<u>\$ 2,442</u>

See accompanying notes to the consolidated financial statements.

MIDDLEFIELD BANC CORP.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(Dollar amounts in thousands, except dividend per share amount)

	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2009	1,754,112	\$ 27,919	\$ 14,960	\$ 562	\$ (6,734)	\$ 36,707
Net income			2,517			2,517
Other comprehensive loss				(75)		(75)
Dividend reinvestment and purchase plan	26,441	510				510
Cash dividends (\$1.04 per share)			(1,637)			(1,637)
Balance, December 31, 2010	1,780,553	\$ 28,429	\$ 15,840	\$ 487	\$ (6,734)	\$ 38,022
Net income			4,130			4,130
Other comprehensive income				4,054		4,054
Stock-based compensation expense	2,400	59				59
Common stock issuance	138,150	2,210				2,210
Dividend reinvestment and purchase plan	30,765	542				542
Cash dividends (\$1.04 per share)			(1,764)			(1,764)
Balance, December 31, 2011	1,951,868	\$ 31,240	\$ 18,206	\$ 4,541	\$ (6,734)	\$ 47,253
Net income			6,281			6,281
Other comprehensive income				850		850
Stock-based compensation expense	1,722	32				32
Common stock issuance	196,635	2,329				2,329
Dividend reinvestment and purchase plan	31,538	694				694
Cash dividends (\$1.04 per share)			(2,002)			(2,002)
Balance, December 31, 2012	<u>2,181,763</u>	<u>\$ 34,295</u>	<u>\$ 22,485</u>	<u>\$ 5,391</u>	<u>\$ (6,734)</u>	<u>\$ 55,437</u>

See accompanying notes to the consolidated financial statements.

MIDDLEFIELD BANC CORP.
CONSOLIDATED STATEMENT OF CASH FLOWS
(Dollar amounts in thousands)

	Year Ended December 31,		
	2012	2011	2010
OPERATING ACTIVITIES			
Net income	\$ 6,281	\$ 4,130	\$ 2,517
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	2,168	3,085	3,580
Investment securities (gains) losses, net	(610)	173	(11)
Depreciation and amortization	929	731	740
Amortization of premium and discount on investment securities	930	451	6
Amortization of deferred loan fees, net	(188)	(170)	(58)
Origination of loans held for sale	(1,084)	-	-
Proceeds from sale of loans held for sale	1,169	-	-
Gains on sale of loans	(85)	-	-
Earnings on bank-owned life insurance	(279)	(278)	(273)
Deferred income taxes	2	(97)	(777)
Stock-based compensation expense	32	59	-
Loss on other real estate owned	258	497	783
Decrease (increase) in accrued interest receivable	71	25	(847)
Decrease in accrued interest payable	(153)	(145)	(115)
Decrease in prepaid federal deposit insurance	486	707	727
Other, net	355	(22)	(538)
Net cash provided by operating activities	<u>10,282</u>	<u>9,146</u>	<u>5,734</u>
INVESTING ACTIVITIES			
Investment securities available for sale:			
Proceeds from repayments and maturities	50,919	69,264	42,815
Proceeds from sale of securities	32,985	24,127	5,874
Purchases	(83,431)	(80,078)	(113,860)
Increase in loans, net	(8,435)	(32,956)	(22,992)
Proceeds from the sale of other real estate owned	954	866	932
Purchase of premises and equipment	(997)	(583)	(327)
Net cash used for investing activities	<u>(8,005)</u>	<u>(19,360)</u>	<u>(87,558)</u>
FINANCING ACTIVITIES			
Net increase in deposits	12,373	15,711	78,145
(Decrease) increase in short-term borrowings, net	(854)	(240)	832
Repayment of other borrowings	(3,861)	(2,490)	(6,544)
Common stock issued	2,329	2,210	-
Proceeds from dividend reinvestment and purchase plan	694	542	510
Cash dividends	(2,002)	(1,764)	(1,637)
Net cash provided by financing activities	<u>8,679</u>	<u>13,969</u>	<u>71,306</u>
Increase (decrease) in cash and cash equivalents	10,956	3,755	(10,518)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>34,390</u>	<u>30,635</u>	<u>41,153</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 45,346</u>	<u>\$ 34,390</u>	<u>\$ 30,635</u>
SUPPLEMENTAL INFORMATION			
Cash paid during the year for:			
Interest on deposits and borrowings	\$ 6,600	\$ 8,797	\$ 11,060
Income taxes	1,550	615	850
Non-cash investing transactions:			
Transfers from loans to other real estate owned	\$ 862	\$ 1,257	\$ 2,110
Loans to facilitate the sale of other real estate owned	-	-	257

See accompanying notes to the consolidated financial statements.

MIDDLEFIELD BANC CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting and reporting policies applied in the presentation of the accompanying financial statements follows:

Nature of Operations and Basis of Presentation

Middlefield Banc Corp. (the “Company”) is an Ohio corporation organized to become the holding company of The Middlefield Banking Company (“MBC”). MBC is a state-chartered bank located in Ohio. On April 19, 2007, Middlefield Banc Corp. acquired Emerald Bank (“EB”), an Ohio-chartered commercial bank headquartered in Dublin, Ohio. On October 23, 2009, the Company established an asset resolution subsidiary named EMORECO, Inc. The Company and its subsidiaries derive substantially all of their income from banking and bank-related services, which includes interest earnings on residential real estate, commercial mortgage, commercial and consumer financings as well as interest earnings on investment securities and deposit services to its customers through ten locations. The Company is supervised by the Board of Governors of the Federal Reserve System, while MBC and EB are subject to regulation and supervision by the Federal Deposit Insurance Corporation and the Ohio Division of Financial Institutions.

The consolidated financial statements of the Company include its wholly owned subsidiaries, MBC, EB, and EMORECO, Inc. (the “Banks”). Significant intercompany items have been eliminated in preparing the consolidated financial statements.

The financial statements have been prepared in conformity with U.S. generally accepted accounting principles. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the balance sheet date and revenues and expenses for the period. Actual results could differ significantly from those estimates.

Investment Securities

Investment securities are classified at the time of purchase, based on management’s intention and ability, as securities held to maturity or securities available for sale. Debt securities acquired with the intent and ability to hold to maturity are stated at cost adjusted for amortization of premium and accretion of discount, which are computed using a level yield method and recognized as adjustments of interest income. Certain other debt securities have been classified as available for sale to serve principally as a source of liquidity. Unrealized holding gains and losses for available-for-sale securities are reported as a separate component of stockholders’ equity, net of tax, until realized. Realized security gains and losses are computed using the specific identification method. Interest and dividends on investment securities are recognized as income when earned.

Common stock of the Federal Home Loan Bank (“FHLB”) represents ownership in an institution that is wholly owned by other financial institutions. This equity security is accounted for at cost and classified with other assets. While the FHLBs have been negatively impacted by economic conditions of the past several years, the FHLB of Cincinnati has reported profits for 2012 and 2011, remains in compliance with regulatory capital and liquidity requirements, and continues to pay dividends on the stock and make redemptions at the par value. With consideration given to these factors, management concluded that the stock was not impaired at December 31, 2012 or 2011.

Securities are evaluated on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value is other than temporary. For debt securities, management considers whether the present value of cash flows expected to be collected are less than the security’s amortized cost basis (the difference defined as the credit loss), the magnitude and duration of the decline, the reasons underlying the decline and the Company’s intent to sell the security or whether it is more likely than not that the Company would be required to sell the security before its anticipated recovery in market value, to determine whether the loss in value is other than temporary. Once a decline in value is determined to be other than temporary, if the investor does not intend to sell the security, and it is more-likely-than-not that it will not be required to sell the security, before recovery of the security’s amortized cost basis, the charge to earnings is limited to the amount of credit loss. Any remaining difference between fair value and amortized cost (the difference defined as the non-credit

portion) is recognized in other comprehensive income, net of applicable taxes. Otherwise, the entire difference between fair value and amortized cost is charged to earnings.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff generally are reported at their outstanding unpaid principal balances net of the allowance for loan losses. Interest income is recognized as income when earned on the accrual method. The accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions, the borrower's financial condition is such that collection of interest is doubtful. Interest received on nonaccrual loans is recorded as income or applied against principal according to management's judgment as to the collectability of such principal.

Loan origination fees and certain direct loan origination costs are being deferred and the net amount amortized as an adjustment of the related loan's yield. Management is amortizing these amounts over the contractual life of the related loans.

Allowance for Loan Losses

The allowance for loan losses represents the amount which management estimates is adequate to provide for probable loan losses inherent in its loan portfolio. The allowance method is used in providing for loan losses. Accordingly, all loan losses are charged to the allowance, and all recoveries are credited to it. The allowance for loan losses is established through a provision for loan losses which is charged to operations. The provision is based on management's periodic evaluation of the adequacy of the allowance for loan losses, which encompasses the overall risk characteristics of the various portfolio segments, past experience with losses, the impact of economic conditions on borrowers, and other relevant factors. The estimates used in determining the adequacy of the allowance for loan losses, including the amounts and timing of future cash flows expected on impaired loans, are particularly susceptible to significant change in the near term.

A loan is considered impaired when it is probable the borrower will not repay the loan according to the original contractual terms of the loan agreement. Management has determined that first mortgage loans on one-to-four family properties and all consumer loans represent large groups of smaller-balance homogeneous loans that are to be collectively evaluated. Loans that experience insignificant payment delays, which are defined as 90 days or less, generally are not classified as impaired. A loan is not impaired during a period of delay in payment if the Company expects to collect all amounts due, including interest accrued, at the contractual interest rate for the period of delay. All loans identified as impaired are evaluated independently by management. The Company estimates credit losses on impaired loans based on the present value of expected cash flows or the fair value of the underlying collateral if the loan repayment is expected to come from the sale or operation of such collateral. Impaired loans, or portions thereof, are charged off when it is determined a realized loss has occurred. Until such time, an allowance for loan losses is maintained for estimated losses. Cash receipts on impaired loans are applied first to accrued interest receivable unless otherwise required by the loan terms, except when an impaired loan is also a nonaccrual loan, in which case the portion of the payment related to interest is recognized as income.

Mortgage loans secured by one-to-four family properties and all consumer loans are large groups of smaller-balance homogeneous loans and are measured for impairment collectively. Management determines the significance of payment delays on a case-by-case basis, taking into consideration all circumstances concerning the loan, the creditworthiness and payment history of the borrower, the length of the payment delay, and the amount of shortfall in relation to the principal and interest owed.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost net of accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the assets, which range from 3 to 20 years for furniture, fixtures, and equipment and 3 to 40 years for buildings and leasehold improvements. Expenditures for maintenance and repairs are charged against income as incurred. Costs of major additions and improvements are capitalized.

Goodwill

The Company accounts for goodwill using a two-step process for testing the impairment of goodwill on at least an annual basis. This approach could cause more volatility in the Company's reported net income because impairment losses, in any, could occur irregularly and in varying amounts. No impairment of goodwill was recognized in any of the periods presented.

Intangible Assets

Intangible assets include core deposit intangibles, which are a measure of the value of consumer demand and savings deposits acquired in business combinations accounted for as purchases. The core deposit intangibles are being amortized to expense over a 10 year life on a straight-line basis. The recoverability of the carrying value of intangible assets is evaluated on an ongoing basis, and permanent declines in value, if any, are charged to expense.

Bank-Owned Life Insurance ("BOLI")

The Company owns insurance on the lives of a certain group of key employees. The policies were purchased to help offset the increase in the costs of various fringe benefit plans including healthcare. The cash surrender value of these policies is included as an asset on the Consolidated Balance Sheet and any increases in the cash surrender value are recorded as noninterest income on the Consolidated Statement of Income. In the event of the death of an insured individual under these policies, the Company would receive a death benefit, which would be recorded as noninterest income.

Other Real Estate Owned

Real estate properties acquired through foreclosure are initially recorded at fair value at the date of foreclosure, establishing a new cost basis. After foreclosure, management periodically performs valuations and the real estate is carried at the lower of cost or fair value less estimated cost to sell. Revenue and expenses from operations of the properties, gains or losses on sales and additions to the valuation allowance are included in operating results.

Income Taxes

The Company and its subsidiaries file a consolidated federal income tax return. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Earnings Per Share

The Company provides dual presentation of basic and diluted earnings per share. Basic earnings per share are calculated utilizing net income as reported in the numerator and average shares outstanding in the denominator. The computation of diluted earnings per share differs in that the dilutive effects of any stock options, warrants, and convertible securities are adjusted in the denominator.

Stock-Based Compensation

The Company accounts for stock compensation based on the grant date fair value of all share-based payment awards that are expected to vest, including employee share options to be recognized as employee compensation expense over the requisite service period.

For purposes of computing results, the Company estimated the fair values of stock options using the Black-Scholes option-pricing model. The model requires the use of subjective assumptions that can materially affect fair value estimates. The fair value of each option is amortized into compensation expense on a straight-line basis between the grant date for the option and each vesting date. The fair value of each stock option granted was estimated using the following weighted-average assumptions:

<u>Grant Year</u>	<u>Expected Dividend Yield</u>	<u>Risk-Free Interest Rate</u>	<u>Expected Volatility</u>	<u>Expected Life (in years)</u>
2011	5.82%	3.00%	21.78	9.96

During the years ended December 31, 2012, 2011, and 2010, the Company recorded \$0, \$16,000, and \$0, of compensation cost related to vested stock options. As of December 31, 2012, there was no unrecognized compensation cost related to unvested stock options. The weighted-average fair value of the stock option granted for 2011 was \$1.75.

The Company also issued 1,722 and 2,400 shares of restricted stock and recorded stock-based compensation expense of \$32,000 and \$43,000 in 2012 and 2011, respectively.

Cash Flow Information

The Company has defined cash and cash equivalents as those amounts included in the Consolidated Balance Sheet captions as “Cash and due from banks” and “Federal funds sold” with original maturities of less than 90 days.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expenses amounted to \$423,000, \$439,000, and \$401,000, for 2012, 2011, and 2010, respectively.

Reclassification of Comparative Amounts

Certain comparative amounts for prior years have been reclassified to conform to current-year presentations. Such reclassifications did not affect net income or retained earnings.

Recent Accounting Pronouncements

In September 2011, the FASB issued ASU 2011-08, *Intangibles – Goodwill and Other Topics (Topic 350), Testing Goodwill for Impairment*. The objective of this Update is to simplify how entities, both public and nonpublic, test goodwill for impairment. The amendments in the Update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Under the amendments in this Update, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The amendments in this Update apply to all entities, both public and nonpublic, that have goodwill reported in their financial statements and are effective for interim and annual goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity’s financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance. This ASU did not have a significant impact on the Company’s financial statements.

In December 2011, the FASB issued ASU 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities*. The amendments in this Update affect all entities that have financial instruments and derivative instruments that are either (1) offset in accordance with either Section 210-20-45 or Section 815-10-45 or (2) subject to an enforceable master netting arrangement or similar agreement. The requirements amend the disclosure requirements on offsetting in Section 210-20-50. This information will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position, including the effect or potential effect of rights of setoff associated with certain financial instruments and derivative instruments in the scope of this Update. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. This ASU is not expected to have a significant impact on the Company's financial statements.

2. EARNINGS PER SHARE

There are no convertible securities that would affect the numerator in calculating basic and diluted earnings per share; therefore, net income as presented on the Consolidated Statement of Income will be used as the numerator. The following table sets forth the composition of the weighted-average common shares (denominator) used in the basic and diluted earnings per share computation for year-ended December 31.

	2012	2011	2010
Weighted average common shares outstanding	2,101,490	1,872,582	1,764,743
Average treasury stock shares	(189,530)	(189,530)	(189,530)
Weighted average common shares and common stock equivalents used to calculate basic earnings per share	1,911,960	1,683,052	1,575,213
Additional common stock equivalents used to calculate diluted earnings per share	4,972	-	608
Weighted average common shares and common stock equivalents used to calculate diluted earnings per share	<u>1,916,932</u>	<u>1,683,052</u>	<u>1,575,821</u>

Options to purchase 79,693 shares of common stock at prices ranging from \$17.55 to \$40.24 were outstanding during the year ended December 31, 2012. Of those options, 8,875 were considered dilutive based on the average market price exceeding the strike price for the year ended December 31, 2012. In accordance with the subscription agreement entered into by an institutional investor, there was also an additional 12,419 shares, at \$16 per share, considered dilutive for the year ended December 31, 2012. The remaining options had no dilutive effect on the earnings per share.

Options to purchase 88,774 shares of common stock at prices ranging from \$17.55 to \$40.24 were outstanding during the year ended December 31, 2011, but were not included in the computation of diluted earnings per share as they were anti-dilutive due to the strike price being greater than the average market price as of December 31, 2011.

Options to purchase 89,077 shares of common stock at prices ranging from \$22.33 to \$40.24 were outstanding during the year ended December 31, 2010. Of those options, 9,561 were considered dilutive based on the average market price exceeding the strike price for the year ended December 31, 2010.

3. INVESTMENT SECURITIES AVAILABLE FOR SALE

The amortized cost and fair values of securities available for sale are as follows:

(Dollar amounts in thousands)	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	\$ 24,485	\$ 566	(91)	\$ 24,960
Obligations of states and political subdivisions:				
Taxable	6,888	738	-	7,626
Tax-exempt	80,391	4,683	(104)	84,970
Mortgage-backed securities in government-sponsored entities	69,238	1,929	(65)	71,102
Private-label mortgage-backed securities	4,553	511	-	5,064
Total debt securities	185,555	8,427	(260)	193,722
Equity securities in financial institutions	750	-	-	750
Total	<u>\$ 186,305</u>	<u>\$ 8,427</u>	<u>\$ (260)</u>	<u>\$ 194,472</u>

(Dollar amounts in thousands)	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	\$ 31,520	\$ 427	(14)	\$ 31,933
Obligations of states and political subdivisions:				
Taxable	8,207	766	-	8,973
Tax-exempt	75,807	3,681	(61)	79,427
Mortgage-backed securities in government-sponsored entities	63,808	1,819	(54)	65,573
Private-label mortgage-backed securities	7,005	411	(95)	7,321
Total debt securities	186,347	7,104	(224)	193,227
Equity securities in financial institutions	750	-	-	750
Total	<u>\$ 187,097</u>	<u>\$ 7,104</u>	<u>\$ (224)</u>	<u>\$ 193,977</u>

The amortized cost and fair value of debt securities at December 31, 2012, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollar amounts in thousands)	Amortized Cost	Fair Value
Due in one year or less	\$ 2,179	\$ 2,239
Due after one year through five years	5,555	5,870
Due after five years through ten years	22,310	23,240
Due after ten years	155,511	162,373
Total	<u>\$ 185,555</u>	<u>\$ 193,722</u>

Investment securities with an approximate carrying value of \$62,518,000 and \$53,724,000 at December 31, 2012 and 2011, respectively, were pledged to secure deposits and other purposes as required by law.

Proceeds from the sales of securities available-for-sale and the gross realized gains and losses for the year ended December, 31 are as follows:

	2012	2011	2010
Proceeds from sales	\$ 32,985	24,127	5,874
Gross realized gains	704	830	74
Gross realized losses	(94)	(809)	(29)
Impairment losses	-	(194)	(34)

The following tables show the Company's gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position.

		December 31, 2012					
		Less than Twelve Months		Twelve Months or Greater		Total	
		Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
(Dollar amounts in thousands)							
U.S. government agency securities	\$ 9,938	\$ (91)	\$ -	\$ -	\$ 9,938	\$ (91)	
Obligations of states and political subdivisions	9,240	(104)	-	-	9,240	(104)	
Mortgage-backed securities in government-sponsored entities	12,353	(65)	-	-	12,353	(65)	
Total	<u>\$ 31,531</u>	<u>\$ (260)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 31,531</u>	<u>\$ (260)</u>	

		December 31, 2011					
		Less than Twelve Months		Twelve Months or Greater		Total	
		Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government agency securities	\$ 1,986	\$ (14)	\$ -	\$ -	\$ 1,986	\$ (14)	
Obligations of states and political subdivisions	2,707	(40)	919	(21)	3,626	(61)	
Mortgage-backed securities in government-sponsored entities	8,992	(54)	-	-	8,992	(54)	
Private-label mortgage-backed securities	1,628	(42)	398	(53)	2,026	(95)	
Total	<u>\$ 15,313</u>	<u>\$ (150)</u>	<u>\$ 1,317</u>	<u>\$ (74)</u>	<u>\$ 16,630</u>	<u>\$ (224)</u>	

There were 34 securities that were considered temporarily impaired at December 31, 2012.

On a quarterly basis, the Company performs an assessment to determine whether there have been any events or economic circumstances indicating that a security with an unrealized loss has suffered other-than-temporary impairment ("OTTI"). A debt security is considered impaired if the fair value is less than its amortized cost basis at the reporting date. The accounting literature requires the Company to assess whether the unrealized loss is other-than-temporary.

OTTI losses are recognized in earnings when the Company has the intent to sell the debt security or it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost basis. However, even if the Company does not expect to sell a debt security, it must evaluate expected cash flows to be received and determine if a credit loss has occurred.

An unrealized loss is generally deemed to be other than temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. As a result the credit loss component of an OTTI is recorded as a component of investment securities gains (losses) in the accompanying Consolidated Statement of Income, while the remaining portion of the impairment loss is recognized in other comprehensive income, provided the Company does not intend to sell the underlying debt security and it is “more likely than not” that the Company will not have to sell the debt security prior to recovery.

Debt securities issued by U.S. government agencies, U.S. government-sponsored enterprises, and state and political subdivisions accounted for more than 97.0 percent of the total available-for-sale portfolio as of December 31, 2012, and no credit losses are expected, given the explicit and implicit guarantees provided by the U.S. federal government and the lack of significant unrealized loss positions within the obligations of state and political subdivisions security portfolio. The Company’s assessment was concentrated mainly on private-label collateralized mortgage obligations of approximately \$4.6 million, for which the Company evaluates credit losses on a quarterly basis. Gross unrealized gains related to private-label collateralized mortgage obligations amounted to \$511,000, with no associated gross unrealized loss. The Company considered the following factors in determining whether a credit loss exists and the period over which the debt security is expected to recover:

- The length of time and the extent to which the fair value has been less than the amortized cost basis.
- Changes in the near term prospects of the underlying collateral of a security such as changes in default rates, loss severity given default and significant changes in prepayment assumptions.
- The level of cash flows generated from the underlying collateral supporting the principal and interest payments of the debt securities.
- Any adverse change to the credit conditions and liquidity of the issuer, taking into consideration the latest information available about the overall financial condition of the issuer, credit ratings, recent legislation, and government actions affecting the issuer’s industry and actions taken by the issuer to deal with the present economic climate.

The Company determined equity securities in financial institutions to be other than temporarily impaired and recognized a loss of \$194,000 in 2011. In 2010, investment in a private-label collateralized mortgage obligation was deemed impaired, resulting in a loss of \$35,000. These amounts represent a before-tax, non-cash charge, and were recorded as reductions to noninterest income.

4. LOANS AND RELATED ALLOWANCE FOR LOAN LOSSES

Major classifications of loans at December 31 are summarized as follows (in thousands):

	2012	2011
Commercial and industrial	\$ 62,188	\$ 59,185
Real estate - construction	22,522	21,545
Real estate - mortgage:		
Residential	203,872	208,139
Commercial	115,734	108,502
Consumer installment	4,117	4,509
	408,433	401,880
Less allowance for loan losses	(7,779)	(6,819)
Net loans	<u>\$ 400,654</u>	<u>\$ 395,061</u>

The Company's primary business activity is with customers located within its local trade area, eastern Geauga County, and contiguous counties to the north, east, and south. The Company also serves the central Ohio market with offices in Dublin and Westerville, Ohio. Commercial, residential, consumer, and agricultural loans are granted. Although the Company has a diversified loan portfolio at December 31, 2012 and 2011, loans outstanding to individuals and businesses are dependent upon the local economic conditions in its immediate trade area.

The following table summarizes the primary segments of the loan portfolio and the allowance for loan losses as of December 31, 2012 and 2011 (in thousands):

	December 31, 2012	Commercial and industrial	Real estate- construction	Real Estate- Mortgage		Consumer installment	Total
				Residential	Commercial		
Loans:							
Individually evaluated for impairment		\$ 4,592	\$ 3,993	\$ 5,761	\$ 6,914	\$ 28	\$ 21,288
Collectively evaluated for impairment		57,596	18,529	198,111	108,820	4,089	387,145
Total loans		<u>\$ 62,188</u>	<u>\$ 22,522</u>	<u>\$ 203,872</u>	<u>\$ 115,734</u>	<u>\$ 4,117</u>	<u>\$ 408,433</u>
	December 31, 2011	Commercial and industrial	Real estate- construction	Real estate- Mortgage		Consumer installment	Total
				Residential	Commercial		
Loans:							
Individually evaluated for impairment		\$ 4,492	\$ 867	\$ 4,882	\$ 6,491	\$ -	\$ 16,732
Collectively evaluated for impairment		54,693	20,678	203,257	102,011	4,509	385,148
Total loans		<u>\$ 59,185</u>	<u>\$ 21,545</u>	<u>\$ 208,139</u>	<u>\$ 108,502</u>	<u>\$ 4,509</u>	<u>\$ 401,880</u>
	December 31, 2012	Commercial and industrial	Real estate- construction	Real Estate- Mortgage		Consumer installment	Total
				Residential	Commercial		
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment		\$ 1,189	\$ 933	\$ 600	\$ 960	\$ 6	\$ 3,688
Collectively evaluated for impairment		543	190	2,272	1,031	55	4,091
Total ending allowance balance		<u>\$ 1,732</u>	<u>\$ 1,123</u>	<u>\$ 2,872</u>	<u>\$ 1,991</u>	<u>\$ 61</u>	<u>\$ 7,779</u>
	December 31, 2011	Commercial and industrial	Real estate- construction	Real Estate- Mortgage		Consumer installment	Total
				Residential	Commercial		
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment		\$ 595	\$ 237	\$ 685	\$ 185	\$ -	\$ 1,702
Collectively evaluated for impairment		701	201	3,046	1,121	48	5,117
Total ending allowance balance		<u>\$ 1,296</u>	<u>\$ 438</u>	<u>\$ 3,731</u>	<u>\$ 1,306</u>	<u>\$ 48</u>	<u>\$ 6,819</u>

The Company's loan portfolio is segmented to a level that allows management to monitor risk and performance. The portfolio is segmented into Commercial and Industrial ("C & I"), Real Estate Construction, Real Estate – Mortgage, which is further segmented into Residential and Commercial real estate, and Consumer Installment Loans. The C&I loan segment consists of loans made for the purpose of financing the activities of commercial customers. The residential mortgage loan segment consists of loans made for the purpose of financing the activities of residential homeowners. The commercial mortgage loan segment consists of loans made for the purpose of financing the activities of commercial real estate owners and operators. The consumer loan segment consists primarily of installment loans and overdraft lines of credit connected with customer deposit accounts.

Management evaluates individual loans in all of the commercial segments for possible impairment if the loan is greater than \$150,000 and if the loan is either in nonaccrual status or is risk-rated Substandard and is greater than 90 days past due. Loans are considered to be impaired when, based on current information and events, it is probable that the Company 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 evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. 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. The Company does not separately evaluate individual consumer and residential mortgage loans for impairment, unless such loans are part of a larger relationship that is impaired. All TDRs are evaluated for possible impairment, irrespective of risk rating or category.

Once the determination has been made that a loan is impaired, the determination of whether a specific allocation of the allowance is necessary is measured by comparing the recorded investment in the loan with the fair value of the loan using one of three methods: (a) the present value of expected future cash flows discounted at the loan's effective interest rate; (b) the loan's observable market price; or (c) the fair value of the collateral less selling costs. The method is selected on a loan-by-loan basis, with management primarily utilizing the fair value of collateral method. The evaluation of the need and amount of a specific allocation of the allowance and whether a loan can be removed from impairment status is made on a quarterly basis. The Company's policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition.

The following tables present impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary (in thousands):

December 31, 2012

Impaired Loans			
	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial and industrial	\$ 1,230	\$ 1,229	\$ -
Real estate - construction	308	308	-
Real estate - mortgage:			
Residential	2,716	2,729	-
Commercial	4,143	4,164	-
Consumer installment	11	11	-
Total	<u>\$ 8,408</u>	<u>\$ 8,441</u>	<u>\$ -</u>
With an allowance recorded:			
Commercial and industrial	\$ 3,362	\$ 3,367	\$ 1,189
Real estate - construction	3,685	3,685	933
Real estate - mortgage:			
Residential	3,045	3,054	600
Commercial	2,771	2,776	960
Consumer installment	17	17	6
Total	<u>\$ 12,880</u>	<u>\$ 12,899</u>	<u>\$ 3,688</u>
Total:			
Commercial and industrial	\$ 4,592	\$ 4,596	\$ 1,189
Real estate - construction	3,993	3,993	933
Real estate - mortgage:			
Residential	5,761	5,783	600
Commercial	6,914	6,940	960
Consumer installment	28	28	6
Total	<u>\$ 21,288</u>	<u>\$ 21,340</u>	<u>\$ 3,688</u>

December 31, 2011

Impaired Loans			
	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial and industrial	\$ 1,172	\$ 1,172	\$ -
Real estate - construction	4,250	4,250	-
Real estate - mortgage:			
Residential	3,188	3,193	-
Commercial	2,528	2,536	-
Consumer installment	24	24	-
Total	<u>\$ 11,162</u>	<u>\$ 11,175</u>	<u>\$ -</u>
With an allowance recorded:			
Commercial and industrial	\$ 465	\$ 465	\$ 196
Real estate - construction	271	271	125
Real estate - mortgage:			
Residential	-	-	-
Commercial	2,555	2,560	551
Total	<u>\$ 3,291</u>	<u>\$ 3,296</u>	<u>\$ 872</u>
Total:			
Commercial and industrial	\$ 1,637	\$ 1,637	\$ 196
Real estate - construction	4,521	4,521	125
Real estate - mortgage:			
Residential	3,188	3,193	-
Commercial	5,083	5,096	551
Consumer installment	24	24	-
Total	<u>\$ 14,453</u>	<u>\$ 14,471</u>	<u>\$ 872</u>

The table above includes troubled debt restructuring totaling \$4.6 million and \$10.0 million as of December 31, 2012 and 2011, respectively.

	As of December 31, 2012		As of December 31, 2011		As of December 31, 2010	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Total:						
Commercial and industrial	\$ 2,776	\$ 348	\$ 1,637	\$ 58	\$ 3,149	\$ 13
Real estate - construction	2,798	156	4,521	216	618	1
Real estate - mortgage:						
Residential	4,263	338	3,188	157	594	-
Commercial	4,717	543	5,083	97	3,320	69
Consumer installment	27	3	24	2	-	-

Modifications
As of December 31, 2012

Troubled Debt Restructurings	Number of Contracts			Pre-Modification Outstanding Recorded Investment
	Rate Forgiveness	Other	Total	
Commercial and industrial	1	12	13	\$ 489
Real estate- construction:	-	-	-	-
Real estate- mortgage:				
Residential	2	7	9	921
Commercial	-	1	1	156
Consumer Installment	-	2	2	11

Troubled Debt Restructurings subsequently defaulted	Number of Contracts	Recorded Investment
Commercial and industrial	6	\$ 256
Real estate- construction:	1	3,622
Real estate- mortgage:		
Residential	2	89
Commercial	-	-
Consumer Installment	1	5

Modifications
As of December 31, 2011

Troubled Debt Restructurings	Number of Contracts			Pre-Modification Outstanding Recorded Investment
	Rate Forgiveness	Other	Total	
Commercial and industrial	-	8	8	\$ 586
Real estate- construction:	-	2	2	3,883
Real estate- mortgage:				
Residential	-	10	10	1,639
Commercial	-	2	2	1,625
Consumer Installment	-	2	2	24

Troubled Debt Restructurings subsequently defaulted	Number of Contracts	Recorded Investment
Commercial and industrial	3	\$ 134
Real estate- construction:	-	-
Real estate- mortgage:		
Residential	-	-
Commercial	-	-
Consumer Installment	2	28

Modifications
As of December 31, 2010

Troubled Debt Restructurings	Number of Contracts			Pre-Modification Outstanding Recorded Investment
	Rate Forgiveness	Other	Total	
Commercial and industrial	-	7	7	\$ 668
Real estate- mortgage:				
Residential	-	8	8	1,230
Commercial	-	3	3	2,025
Consumer Installment	-	3	3	43

Troubled Debt Restructurings subsequently defaulted	Number of Contracts	Recorded Investment
Commercial and industrial	2	\$ 174
Real estate- mortgage:		
Residential	3	203
Commercial	-	-
Consumer Installment	-	-

Management uses a nine-point internal risk-rating system to monitor the credit quality of the overall loan portfolio. The first five categories are considered not criticized and are aggregated as Pass-rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due are considered Substandard. Any portion of a loan that has been charged off is placed in the Loss category.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Company has a structured loan-rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as bankruptcy, repossession, or death, occurs to raise awareness of a possible credit event. The Company's Commercial Loan Officers are responsible for the timely and accurate risk rating of the loans in their portfolios at origination and on an ongoing basis. The Credit Department performs an annual review of all commercial relationships \$200,000 or greater. Confirmation of the appropriate risk grade is included in the review on an ongoing basis. The Company has an experienced Loan Review Department that continually reviews and assesses loans within the portfolio. The Company engages an external consultant to conduct loan reviews on a semiannual basis. Generally, the external consultant reviews commercial relationships greater than \$250,000 and/or criticized relationships greater than \$125,000. Detailed reviews, including plans for resolution, are performed on loans classified as Substandard on a quarterly basis. Loans in the Special Mention and Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

The following table presents the classes of the loan portfolio summarized by the aggregate Pass rating and the criticized categories of Special Mention, Substandard, and Doubtful within the internal risk rating system as of December 31, 2012 and 2011 (in thousands):

	Pass	Special Mention	Substandard	Doubtful	Total Loans
December 31, 2012					
Commercial and industrial	\$ 59,390	\$ 678	\$ 2,061	\$ 59	\$ 62,188
Real estate - construction	17,601	-	4,921	-	22,522
Real estate - mortgage:					
Residential	190,967	758	12,147	-	203,872
Commercial	106,509	1,928	7,297	-	115,734
Consumer installment	4,084	-	33	-	4,117
Total	<u>\$ 378,551</u>	<u>\$ 3,364</u>	<u>\$ 26,459</u>	<u>\$ 59</u>	<u>\$ 408,433</u>
December 31, 2011					
Commercial and industrial	\$ 53,645	\$ 1,104	\$ 4,363	\$ 73	\$ 59,185
Real estate - construction	20,883	-	662	-	21,545
Real estate - mortgage:					
Residential	192,534	1,100	14,505	-	208,139
Commercial	100,536	443	7,523	-	108,502
Consumer installment	4,495	6	8	-	4,509
Total	<u>\$ 372,093</u>	<u>\$ 2,653</u>	<u>\$ 27,061</u>	<u>\$ 73</u>	<u>\$ 401,880</u>

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of December 31, 2012 and 2011 (in thousands):

		Still Accruing					
	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days+ Past Due	Total Past Due	Non- Accrual	Total Loans
December 31, 2012							
Commercial and industrial	\$ 60,428	\$ 441	\$ 63	\$ 348	\$ 852	\$ 908	\$ 62,188
Real estate - construction	22,158	-	-	-	-	364	22,522
Real estate - mortgage:							
Residential	191,349	2,614	1,401	90	4,105	8,418	203,872
Commercial	113,023	509	97	-	606	2,105	115,734
Consumer installment	4,074	25	-	-	25	18	4,117
Total	<u>\$ 391,032</u>	<u>\$ 3,589</u>	<u>\$ 1,561</u>	<u>\$ 438</u>	<u>\$ 5,588</u>	<u>\$ 11,813</u>	<u>\$ 408,433</u>

	Current	Still Accruing				Non-Accrual	Total Loans
		30-59 Days Past Due	60-89 Days Past Due	90 Days+ Past Due	Total Past Due		
December 31, 2011							
Commercial and industrial	\$ 57,291	\$ 258	\$ 16	\$ 44	\$ 318	\$ 1,576	\$ 59,185
Real estate - construction	20,862	20	-	-	20	663	21,545
Real estate - mortgage:							
Residential	193,732	2,624	863	275	3,762	10,645	208,139
Commercial	104,086	83	412	-	495	3,921	108,502
Consumer installment	4,408	60	41	-	101	-	4,509
Total	<u>\$ 380,379</u>	<u>\$ 3,045</u>	<u>\$ 1,332</u>	<u>\$ 319</u>	<u>\$ 4,696</u>	<u>\$ 16,805</u>	<u>\$ 401,880</u>

Interest income that would have been recorded had these loans not been placed on nonaccrual status was \$756,000 in 2012; \$859,000 in 2011; and \$470,000 in 2010.

An allowance for loan losses (“ALL”) is maintained to absorb losses from the loan portfolio. The ALL is based on management’s continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of non-performing loans.

The Company’s methodology for determining the ALL is based on the requirements of ASC Section 310-10-35 for loans individually evaluated for impairment (discussed above) and ASC Subtopic 450-20 for loans collectively evaluated for impairment, as well as the Interagency Policy Statement on the Allowance for Loan and Lease Losses and other bank regulatory guidance. The total of the two components represents the Company’s ALL.

Loans that are collectively evaluated for impairment are analyzed, with general allowances being made as appropriate. For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are modified by other qualitative factors.

The classes described above, which are based on the purpose code assigned to each loan, provide the starting point for the ALL analysis. Management tracks the historical net charge-off activity at the purpose code level. A historical charge-off factor is calculated utilizing the last four consecutive quarters.

Management has identified a number of additional qualitative factors which it uses to supplement the historical charge-off factor, because these factors are likely to cause estimated credit losses associated with the existing loan pools to differ from historical loss experience. The additional factors that are evaluated quarterly and updated using information obtained from internal, regulatory, and governmental sources are: national and local economic trends and conditions; levels of and trends in delinquency rates and non-accrual loans; trends in volumes and terms of loans; effects of changes in lending policies; experience, ability, and depth of lending staff; value of underlying collateral; and concentrations of credit from a loan type, industry, and/or geographic standpoint.

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL.

The following tables summarize the primary segments of the loan portfolio (in thousands):

	Commercial and industrial	Real estate- construction	Real estate- residential mortgage	Real estate- commercial mortgage	Consumer installment	Total
ALL balance at December 31, 2011	\$ 1,296	\$ 438	\$ 3,731	\$ 1,306	\$ 48	\$ 6,819
Charge-offs	(230)	(135)	(785)	(123)	(64)	(1,337)
Recoveries	71	-	31	-	27	129
Provision	595	820	(105)	808	50	2,168
ALL balance at December 31, 2012	<u>\$ 1,732</u>	<u>\$ 1,123</u>	<u>\$ 2,872</u>	<u>\$ 1,991</u>	<u>\$ 61</u>	<u>\$ 7,779</u>

	Commercial and industrial	Real estate- construction	Real estate- residential mortgage	Real estate- commercial mortgage	Consumer installment	Total
ALL balance at December 31, 2010	\$ 1,234	\$ 356	\$ 3,392	\$ 1,143	\$ 96	\$ 6,221
Charge-offs	(568)	(6)	(1,862)	(265)	(11)	(2,712)
Recoveries	76	-	122	-	27	225
Provision	554	88	2,079	428	(64)	3,085
ALL balance at December 31, 2011	<u>\$ 1,296</u>	<u>\$ 438</u>	<u>\$ 3,731</u>	<u>\$ 1,306</u>	<u>\$ 48</u>	<u>\$ 6,819</u>

	Commercial and industrial	Real estate- construction	Real estate- residential mortgage	Real estate- commercial mortgage	Consumer installment	Total
ALL balance at December 31, 2009	\$ 864	\$ -	\$ 2,816	\$ 1,198	\$ 59	\$ 4,937
Charge-offs	(450)	-	(1,433)	(428)	(59)	(2,370)
Recoveries	40	-	-	-	34	74
Provision	780	356	2,009	373	62	3,580
ALL balance at December 31, 2010	<u>\$ 1,234</u>	<u>\$ 356</u>	<u>\$ 3,392</u>	<u>\$ 1,143</u>	<u>\$ 96</u>	<u>\$ 6,221</u>

5. PREMISES AND EQUIPMENT

Major classifications of premises and equipment at December 31 are summarized as follows:

(Dollar amounts in thousands)	2012	2011
Land and land improvements	\$ 1,885	\$ 1,898
Building and leasehold improvements	9,427	9,131
Furniture, fixtures, and equipment	3,665	2,952
	<u>14,977</u>	<u>13,981</u>
Less accumulated depreciation and amortization	<u>6,307</u>	<u>5,717</u>
Total	<u>\$ 8,670</u>	<u>\$ 8,264</u>

Depreciation charged to operations was \$591,000 in 2012, \$499,000 in 2011, and \$542,000 in 2010.

6. GOODWILL AND INTANGIBLE ASSETS

Goodwill totaled \$4,559,000 at the years ended December 31, 2012, and 2011. Core deposit intangible gross carrying amount was \$195,000 and \$235,000 for the years ended December 31, 2012, and 2011. Core deposit accumulated amortization was \$200,000 and \$160,000 for the years ended December 31, 2012, and 2011.

Core deposit intangible assets are amortized on a straight-line basis over their estimated lives of ten years. Amortization expense totaled \$40,000 in 2012, 2011, and 2010. The estimated aggregate future amortization expense for core deposit intangible assets as of December 31, 2012, is as follows (in thousands):

2013	\$	40,000
2014		40,000
2015		40,000
2016		40,000
Thereafter		35,000
Total	\$	<u>195,000</u>

7. OTHER ASSETS

The components of other assets at year ended December 31 are as follows:

(Dollar amounts in thousands)	2012	2011
FHLB stock	\$ 1,887	\$ 1,887
Accrued interest on investment securities	1,032	1,185
Accrued interest on loans	1,132	1,049
Deferred tax asset, net	181	621
Prepaid federal deposit insurance	513	977
Other Real Estate Owned	1,846	2,196
Other	1,460	2,128
Total	<u>\$ 8,051</u>	<u>\$ 10,043</u>

8. DEPOSITS

Time deposits at December 31, 2012, mature \$98,028,000, \$35,512,000, \$41,164,000, \$15,097,000, and \$6,952,000 during 2013, 2014, 2015, 2016, and 2017, respectively.

Maturities on time deposits of \$100,000 or more at December 31, 2012, are as follows:

(Dollar amounts in thousands)	Amount	Percent of Total
Within three months	\$ 10,031	12.55%
Beyond three but within six months	9,005	11.27
Beyond six but within twelve months	18,234	22.82
Beyond one year	42,648	53.36
Total	<u>\$ 79,918</u>	<u>100.00%</u>

The aggregate of all time deposit accounts of \$100,000 or more amounted to \$86,793,000 at December 31, 2011.

9. SHORT-TERM BORROWINGS

The year ended December 31 outstanding balances and related information of short-term borrowings, which includes securities sold under agreements to repurchase and short-term borrowings from other banks, are summarized as follows:

(Dollar amounts in thousands)	2012	2011	2010
Balance at year-end	\$ 6,538	\$ 7,392	\$ 7,632
Average balance outstanding	7,005	7,276	7,320
Maximum month-end balance	7,458	7,552	8,178
Weighted-average rate at year-end	2.97%	3.14%	3.10%
Weighted-average rate during the year	3.15%	3.23%	3.40%

Average balances outstanding during the year represent daily average balances, and average interest rates represent interest expense divided by the related average balance.

The Company maintains a \$4,000,000 line of credit at an adjustable rate, currently 3.71 percent, and a \$3,000,000 line of credit at an adjustable rate, currently at 4.00 percent. At December 31, 2012, 2011, and 2010, outstanding borrowings under these lines were \$4,900,000, \$5,700,000, and \$5,700,000, respectively.

10. OTHER BORROWINGS

Other borrowings consist of advances from the FHLB and subordinated debt as follows:

(Dollar amounts in thousands)	Maturity range		Weighted-average	Stated interest rate range		2012	2011
Description	from	to	interest rate	from	to		
Fixed rate amortizing	01/23/13	09/04/28	3.99%	2.70%	4.48%	\$ 4,722	\$ 6,576
Convertible	10/09/12	10/09/12	4.14	4.14	4.14	-	2,007
Junior subordinated debt	12/21/37	12/21/37	2.50	1.98	6.58	8,248	8,248
Total						<u>\$ 12,970</u>	<u>\$ 16,831</u>

The scheduled maturities of other borrowings are as follows:

(Dollar amounts in thousands)	Amount	Average Rate
Year Ending December 31,		
2013	\$ 1,362	3.95%
2014	984	3.99
2015	685	4.01
2016	502	4.00
2017	373	4.00
Beyond 2017	9,065	2.17
Total	<u>\$ 12,970</u>	<u>2.63%</u>

The Company entered into a ten-year “Convertible Select” fixed commitment advance arrangement with the FHLB. Rates may be reset at the FHLB’s discretion on a quarterly basis based on the three-month LIBOR rate. At each rate change, the Company may exercise a put option and satisfy the obligation without penalty.

Fixed rate amortizing advances from the FHLB require monthly principal and interest payments and an annual 20 percent pay-down of outstanding principal. Monthly principal and interest payments are adjusted after each 20 percent pay-down. Under the terms of a blanket agreement, FHLB borrowings are secured by certain qualifying assets of the Company which consist principally of first mortgage loans or mortgage-backed securities. Under this credit arrangement, the Company has a remaining borrowing capacity of approximately \$68.9 million at December 31, 2012.

In December 2006, the Company formed a special purpose entity (“Entity”) to issue \$8,000,000 of floating rate, obligated mandatorily redeemable securities, and \$248,000 in common securities as part of a pooled offering. The rate adjusts quarterly, equal to LIBOR plus 1.67 percent. The Entity may redeem them, in whole or in part, at face value. The Company borrowed the proceeds of the issuance from the Entity in December 2006 in the form of an \$8,248,000 note payable, which is included in the liabilities section of the Company’s Consolidated Balance Sheet.

11. OTHER LIABILITIES

The components of other liabilities are as follows (Dollar amounts in thousands):

	2012	2011
Accrued interest payable	\$ 492	\$ 645
Other	1,516	1,468
Total	<u>\$ 2,008</u>	<u>\$ 2,113</u>

12. INCOME TAXES

The provision (benefit) for federal income taxes consists of:

(Dollar amounts in thousands)	2012	2011	2010
Current payable	\$ 1,660	\$ 693	\$ 689
Deferred	2	(97)	(777)
Total provision (benefit)	<u>\$ 1,662</u>	<u>\$ 596</u>	<u>\$ (88)</u>

The tax effects of deductible and taxable temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows:

(Dollar amounts in thousands)	2012	2011
Deferred tax assets:		
Allowance for loan losses	\$ 2,645	\$ 2,318
Supplemental retirement plan	218	182
Alternative minimum tax credits	-	551
Investment security basis adjustment	66	66
Nonaccrual interest income	508	298
Deferred origination fees, net	189	105
OREO adjustments	116	-
Net operating losses	86	190
Other	47	125
Gross deferred tax assets	<u>3,875</u>	<u>3,835</u>
Deferred tax liabilities:		
Premises and equipment	434	405
Net unrealized gain on securities	2,777	2,339
FHLB stock dividends	225	225
Intangibles	256	208
Other	2	37
Gross deferred tax liabilities	<u>3,694</u>	<u>3,214</u>
Net deferred tax assets	<u>\$ 181</u>	<u>\$ 621</u>

No valuation allowance was established at December 31, 2012 and 2011, in view of the Company's ability to carry-back to taxes paid in previous years and certain tax strategies, coupled with the anticipated future taxable income as evidenced by the Company's earnings potential.

The reconciliation between the federal statutory rate and the Company's effective consolidated income tax rate is as follows:

(Dollar amounts in thousands)	2012		2011		2010	
	Amount	% of Pretax Income	Amount	% of Pretax Income	Amount	% of Pretax Income
Provision at statutory rate	\$ 2,700	34.0%	\$ 1,606	34.0%	\$ 827	34.0%
Tax-free income	(1,095)	-13.8	(1,071)	-22.7	(993)	-40.9
Nondeductible interest expense	48	0.6	61	1.3	76	3.1
Other	9	0.1	-	0.0	2	0.2
Actual tax expense and effective rate	<u>\$ 1,662</u>	<u>20.9%</u>	<u>\$ 596</u>	<u>12.6%</u>	<u>\$ (88)</u>	<u>(3.6) %</u>

There is a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met.

At December 31, 2012 and December 31, 2011, the Company had no unrecognized tax benefits. The Company does not expect the total amount of unrecognized tax benefits to significantly increase within the next 12 months. The Company recognizes interest and penalties on unrecognized tax benefits as a component of income tax expense.

The Company and the Banks are subject to U.S. federal income tax as well as an income tax in the state of Ohio, and the Banks are subject to a capital-based franchise tax in the state of Ohio. The Company and the Banks are no longer subject to examination by taxing authorities for years before December 31, 2009.

13. EMPLOYEE BENEFITS

Retirement Plan

The Banks maintain section 401(k) employee savings and investment plans for all full-time employees and officers of the Banks with more than one year of service. The Banks' contributions to the plans are based on 50 percent matching of voluntary contributions up to 6 percent of compensation. An eligible employee can contribute up to 15 percent of salary. Employee contributions are vested at all times, and MBC contributions are fully vested after six years beginning at the second year in 20 percent increments. EB contributions are vested at 25 percent for less than a year of employment, 50 percent after one year, 75 percent after two years, and fully vested after three years. Contributions for 2012, 2011, and 2010 to these plans amounted to \$125,000, \$104,000, and \$106,000, respectively.

Supplemental Retirement Plan

MBC maintains a Directors' Retirement Plan to provide postretirement payments over a ten-year period to members of the Board of Directors who have completed five or more years of service. The plan requires payment of 25 percent of the final average annual board fees paid to a director in the three years preceding the director's retirement.

The following table illustrates the components of the net periodic pension cost for the Directors' Retirement Plan for the years ended:

	Projected Payments
2013	\$ 34,000
2014	34,000
2015	34,000
2016	29,000
2017	23,000
Thereafter	41,000
Total	<u>\$ 195,000</u>

The retirement plan is available solely for nonemployee directors of The Middlefield Banking Company, but the bank has not entered into any additional retirement arrangements for nonemployee directors since 2001. Of the director participants, all but one have retired, but the ten-year benefit payments for the director who continues to serve began in 2010 because he attained the age 75 retirement age in that year.

Executive Deferred Compensation Plan

The Company maintains an Executive Deferred Compensation Plan (the "Plan") to provide post-retirement payments to members of senior management. The Plan agreements are noncontributory, defined contribution arrangements that provide supplemental retirement income benefits to five officers, with contributions made solely by the Banks. During 2012, 2011, and 2010, the Company contributed \$139,000, \$91,000, and \$92,000, respectively, to the Plan.

Stock Option and Restricted Stock Plan

The Company maintains a stock option and restricted stock plan ("the Plan") for granting incentive stock options, nonqualified stock options, and restricted stock to key officers and employees and nonemployee directors of the Company. A total of 160,000 shares of authorized and unissued or issued common stock are reserved for issuance under the Plan, which expires ten years from the date of stockholder ratification. The per share exercise price of an option granted will not be less than the fair value of a share of common stock on the date the option is granted. No option shall become exercisable earlier than one year from the date the Plan was approved by the stockholders.

The following table presents share data related to the outstanding options:

	2012	Weighted- average Exercise Price	2011	Weighted- average Exercise Price
Outstanding, January 1	88,774	\$ 26.81	89,077	\$ 27.87
Granted	-	-	9,000	17.55
Forfeited	(9,081)	22.94	(9,303)	28.03
Outstanding, December 31	<u>79,693</u>	<u>\$ 27.25</u>	<u>88,774</u>	<u>\$ 26.81</u>
Exercisable, December 31	<u>79,693</u>	<u>\$ 27.25</u>	<u>79,774</u>	<u>\$ 27.85</u>

Stock Option and Restricted Stock Plan

The following table summarizes the characteristics of stock options at December 31, 2012:

Grant Date	Exercise Price	Outstanding			Exercisable	
		Shares	Contractual Average Life	Average Exercise Price	Shares	Average Exercise Price
December 8, 2003	\$ 24.29	18,112	0.94	\$ 24.29	18,112	\$ 24.29
May 12, 2004	27.35	907	1.33	27.35	907	27.35
December 13, 2004	30.45	11,223	1.95	30.45	11,223	30.45
December 14, 2005	36.73	7,163	2.95	36.73	7,163	36.73
December 10, 2006	40.24	3,150	3.95	40.24	3,150	40.24
April 19, 2007	37.33	3,639	4.31	37.33	3,639	37.73
May 16, 2007	37.48	1,337	4.41	37.48	1,337	37.48
December 10, 2007	37.00	2,450	4.95	37.00	2,450	37.00
January 2, 2008	36.25	1,337	5.12	36.25	1,337	36.25
November 10, 2008	23.00	21,500	5.95	23.00	21,500	23.00
May 9, 2011	17.55	8,875	8.41	17.55	8,875	17.55
		<u>79,693</u>			<u>79,693</u>	

For the years ended December 31, 2012, 2011, and 2010, the Company granted 1,722, 2,400, and 110 shares, respectively, of common stock under the Omnibus Equity Plan. The Company recognizes compensation expense in the amount of fair value of the common stock at the grant date and as an addition to stockholders' equity.

14. COMMITMENTS

In the normal course of business, there are various outstanding commitments and certain contingent liabilities which are not reflected in the accompanying consolidated financial statements. These commitments and contingent liabilities represent financial instruments with off-balance sheet risk. The contract or notional amounts of those instruments reflect the extent of involvement in particular types of financial instruments which were composed of the following:

(Dollar amounts in thousands)	2012	2011
Commitments to extend credit	\$ 91,854	\$ 81,402
Standby letters of credit	<u>281</u>	<u>639</u>
Total	<u>\$ 92,135</u>	<u>\$ 82,041</u>

These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the Consolidated Balance Sheet. The Company's exposure to credit loss, in the event of nonperformance by the other parties to the financial instruments, is represented by the contractual amounts as disclosed. The Company minimizes its exposure to credit loss under these commitments by subjecting them to credit approval and review procedures and collateral requirements as deemed necessary. Commitments generally have fixed expiration dates within one year of their origination.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Performance letters of credit represent conditional commitments issued by the Company to guarantee the performance of a customer to a third party. These instruments are issued primarily to support bid or performance-related contracts. The coverage period for these instruments is typically a one-year period with an annual renewal option subject to prior approval by management. Fees earned from the issuance of these letters are recognized over the coverage period. For secured letters of credit, the collateral is typically bank deposit instruments or customer business assets.

Leasing Arrangements

The Company leases certain of its banking facilities under operating leases which contain certain renewal options. As of December 31, 2012, approximate future minimum rental payments, including the renewal options under these leases, are as follows (in thousands):

2013	\$	271
2014	\$	280
2015	\$	284
2016	\$	284
2017	\$	284
Thereafter	\$	284

The above amounts represent minimum rentals not adjusted for possible future increases due to escalation provisions and assume that all renewal option periods will be exercised by the Company. Rent expense approximated \$269,000, \$248,000, and \$234,000 for the years ended December 31, 2012, 2011, and 2010, respectively.

15. REGULATORY RESTRICTIONS

The Company is subject to the regulatory requirements of the Federal Reserve System as a multi-bank holding company. The affiliate banks are subject to regulations of the Federal Deposit Insurance Corporation ("FDIC") and the State of Ohio, Division of Financial Institutions.

In February of 2011 Emerald Bank agreed with the FDIC and the Ohio Division of Financial Institutions that Emerald Bank will take specified actions to correct weaknesses in the bank's condition and operations. The actions that Emerald Bank agreed to take include reducing the bank's concentration of credit in non-owner occupied 1 - 4 family residential mortgage loans, reducing delinquent and classified loans, enhancing credit administration for non-owner occupied residential real estate, developing plans for the reduction of borrower indebtedness on classified and delinquent credits, implementing an earnings improvement plan, maintaining leverage capital of at least 9%, revising the bank's methodology for calculating and determining the adequacy of the allowance for loan losses, and providing to the FDIC and the ODFI notice of proposed dividend payments at least 30 days in advance.

We have conducted an evaluation and reorganization of lending and credit administration personnel, retained collection and workout personnel, and sold \$5.8 million of nonperforming assets EMORECO, Inc., Middlefield Banc Corp.'s nonbank-asset resolution subsidiary established in the fourth quarter of 2009. Middlefield Banc Corp. provided capital of \$500,000 to Emerald Bank in 2010 and \$1.5 million in 2011 so that Emerald Bank would achieve the elevated 9% leverage capital level. At December 31, 2012 Emerald Bank's leverage ratio was 10.61%.

In addition to Emerald Bank maintaining leverage capital of at least 9%, The Middlefield Banking Company committed to the FDIC that The Middlefield Banking Company will maintain capital ratios at levels no lower than its June 30, 2010 ratios (*i.e.*, no lower than 6.25% tier 1 leverage capital and 11.29% total risk-based capital), and Middlefield Banc Corp. committed to the Federal Reserve that Middlefield Banc Corp. will maintain tier 1 leverage capital of at least 7.25% and total risk-based capital of at least 12%, both at the level of the holding company and at the level of The Middlefield Banking Company, the lead bank.

Cash Requirements

The Cleveland district Federal Reserve Bank requires the Company to maintain certain average reserve balances. As of December 31, 2012 and 2011, the Company had required reserves of \$7,063,000 and \$5,419,000 comprising vault cash and a depository amount held with the Federal Reserve Bank.

Loans

Federal law prevents the Company from borrowing from the Banks unless the loans are secured by specific obligations. Further, such secured loans are limited in amount of 10 percent of the Banks' common stock and capital surplus.

Dividends

MBC and EB are subject to dividend restrictions that generally limit the amount of dividends that can be paid by an Ohio state-chartered bank. Under the Ohio Banking Code, cash dividends may not exceed net profits as defined for that year combined with retained net profits for the two preceding years less any required transfers to surplus. Under this formula, for MBC, the amount available for payment of dividends for 2012 approximates \$8,077,000 plus 2012 profits retained up to the date of the dividend declaration. For EB, there is no amount available for payment of dividends for 2012 until the net deficit for the two preceding years of \$144,000 is overcome.

Potential Restrictions

On or about January 14, 2013 an investor to whom we sold a total of 196,635 shares in April of 2012, constituting 9.9% of our stock, obtained from the Ohio Division of Financial Institutions and the Federal Reserve Bank of Cleveland regulatory clearance to acquire up to 24.99% of our stock. The August 15, 2011 Stock Purchase Agreement, as amended, under which we sold shares to the investor provided for sale of up to 24.99% of our stock, subject to the investor obtaining regulatory clearance and subject to other conditions. Although we disclosed in a Form 8-K Current Report filed with the SEC on January 18, 2013 that sale of additional shares to the investor under the terms of the Stock Purchase Agreement will not occur, if the investor nevertheless acquires shares and increases his ownership to 10% or more of our common stock, whether acquiring the shares on the open market or from us, we will become subject to additional restrictions under the terms of the regulatory clearance issued to the investor by the Ohio Division of Financial Institutions. Specifically, for three years after the investor becomes an owner of 10% or more of our stock, we would have to obtain advance approval of the ODFI in order for The Middlefield Banking Company to pay a dividend to Middlefield Banc Corp., and for 12 months we would have to obtain advance written approval of the ODFI for any changes in the composition of Middlefield Banc Corp.'s board or executive management.

16. REGULATORY CAPITAL

Federal regulations require the Company and the Banks to maintain minimum amounts of capital. Specifically, each is required to maintain certain minimum dollar amounts and ratios of Total and Tier I capital to risk-weighted assets and of Tier I capital to average total assets.

In addition to the capital requirements, the Federal Deposit Insurance Corporation Improvement Act ("FDICIA") established five capital categories ranging from "well capitalized" to "critically undercapitalized." Should any institution fail to meet the requirements to be considered "adequately capitalized," it would become subject to a series of increasingly restrictive regulatory actions.

As of December 31, 2012 and 2011, the FDIC categorized the Banks as well capitalized under the regulatory framework for prompt corrective action. To be classified as a well capitalized financial institution, Total risk-based, Tier 1 risk-based, and Tier 1 Leverage capital ratios must be at least 10 percent, 6 percent, and 5 percent, respectively.

The Company's and its subsidiaries' actual capital ratios are presented in the following table that shows that all regulatory capital requirements were met as of December 31, 2012.

(Dollar amounts in thousands)	Middlefield Banc Corp.		The Middlefield Banking Co.		Emerald Bank	
	December 31, 2012		December 31, 2012		December 31, 2012	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to Risk-weighted Assets)						
Actual	\$ 57,784	13.86%	\$ 47,887	13.29%	\$ 8,440	15.45%
For Capital Adequacy Purposes	33,344	8.00	28,822	8.00	4,370	8.00
To Be Well Capitalized	41,680	10.00	36,027	10.00	5,463	10.00
Tier I Capital (to Risk-weighted Assets)						
Actual	\$ 52,543	12.61%	\$ 43,371	12.04%	\$ 7,737	14.16%
For Capital Adequacy Purposes	16,672	4.00	14,411	4.00	2,185	4.00
To Be Well Capitalized	25,008	6.00	21,616	6.00	3,278	6.00
Tier I Capital (to Average Assets)						
Actual	\$ 52,543	7.88%	\$ 43,371	7.32%	\$ 7,737	10.61%
For Capital Adequacy Purposes	26,675	4.00	23,684	4.00	2,916	4.00
To Be Well Capitalized	33,344	5.00	29,605	5.00	3,646	5.00

See Note 15 for additional information concerning regulatory capital requirements

The Company's and its subsidiaries' actual capital ratios are presented in the following table that shows that all regulatory capital requirements were met as of December 31, 2011.

	Middlefield Banc Corp.		The Middlefield Banking Co.		Emerald Bank	
	December 31, 2011		December 31, 2011		December 31, 2011	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to Risk-weighted Assets)						
Actual	\$ 49,915	12.06%	\$ 42,185	11.75%	\$ 7,456	13.82%
For Capital Adequacy Purposes	33,101	8.00	28,722	8.00	4,317	8.00
To Be Well Capitalized	41,376	10.00	35,903	10.00	5,396	10.00
Tier I Capital (to Risk-weighted Assets)						
Actual	\$ 44,723	10.81%	\$ 37,697	10.50%	\$ 6,782	12.57%
For Capital Adequacy Purposes	16,551	4.00	14,361	4.00	2,158	4.00
To Be Well Capitalized	24,826	6.00	21,542	6.00	3,237	6.00
Tier I Capital (to Average Assets)						
Actual	\$ 44,723	7.13%	\$ 37,697	6.75%	\$ 6,782	9.92%
For Capital Adequacy Purposes	25,079	4.00	22,325	4.00	2,734	4.00
To Be Well Capitalized	31,349	5.00	27,906	5.00	3,417	5.00

17. FAIR VALUE DISCLOSURE MEASUREMENTS

The following disclosures show the hierarchal disclosure framework associated with the level of pricing observations utilized in measuring assets and liabilities at fair value. The three broad levels defined by U.S. generally accepted accounting principles are as follows:

- Level I: Quoted prices are available in active markets for identical assets or liabilities as of the reported date.
- Level II: Pricing inputs are other than the quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities includes items for which quoted prices are available but traded less frequently and items that are fair-valued using other financial instruments, the parameters of which can be directly observed.
- Level III: Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires the use of observable market data when available.

The following table presents the assets reported on the balance sheet at their fair value as of December 31, 2012 and 2011, by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

		December 31, 2012			
(Dollar amounts in thousands)		Level I	Level II	Level III	Total
Assets measured on a recurring basis:					
U.S. government agency securities	\$	-	\$ 24,960	\$ -	\$ 24,960
Obligations of states and political subdivisions		-	92,596	-	92,596
Mortgage-backed securities in government- sponsored entities		-	71,102	-	71,102
Private-label mortgage-backed securities		-	5,064	-	5,064
Total debt securities		-	193,722	-	193,722
Equity securities in financial institutions		5	745	-	750
Total	\$	5	\$ 194,467	\$ -	\$ 194,472
		December 31, 2011			
		Level I	Level II	Level III	Total
Assets measured on a recurring basis:					
U.S. government agency securities	\$	-	\$ 31,933	\$ -	\$ 31,933
Obligations of states and political subdivisions		-	88,400	-	88,400
Mortgage-backed securities in government- sponsored entities		-	65,573	-	65,573
Private-label mortgage-backed securities		-	7,321	-	7,321
Total debt securities		-	193,227	-	193,227
Equity securities in financial institutions		5	745	-	750
Total	\$	5	\$ 193,972	\$ -	\$ 193,977

Financial instruments are considered Level III when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. In addition to these unobservable inputs, the valuation models for Level III financial instruments typically also rely on a number of inputs that are readily observable either directly or indirectly. Level III financial instruments also include those for which the determination of fair value requires significant management judgment or estimation.

The following tables present the assets measured on a nonrecurring basis on the Consolidated Balance Sheet at their fair value by level within the fair value hierarchy. Impaired loans that are collateral-dependent are written down to fair

value through the establishment of specific reserves. Techniques used to value the collateral that secure the impaired loan include: quoted market prices for identical assets classified as Level I inputs and observable inputs, employed by certified appraisers, for similar assets classified as Level II inputs. In cases where valuation techniques included inputs that are unobservable and are based on estimates and assumptions developed by management based on the best information available under each circumstance, the asset valuation is classified as Level III inputs.

	<u>December 31, 2012</u>			
(Dollar amounts in thousands)	<u>Level I</u>	<u>Level II</u>	<u>Level III</u>	<u>Total</u>
Assets measured on a non-recurring basis:				
Impaired loans	\$ -	\$ -	\$ 17,600	\$ 17,600
Other real estate owned	-	-	1,846	1,846

		<u>December 31, 2011</u>				
		<u>Level I</u>	<u>Level II</u>	<u>Level III</u>	<u>Total</u>	
Assets measured on a non-recurring basis:						
Impaired loans	\$	-	\$	-	\$ 13,581	\$ 13,581
Other real estate owned		-	-	2,196		2,196

The following table presents additional quantitative information about assets measured at fair value on a non-recurring basis and for which the Company uses Level III inputs to determine fair value:

(unaudited, in thousands)	Quantitative Information about Level III Fair Value Measurements				
	Estimate	Valuation Technique	Unobservable Input	Range (Weighted Average)	
December 31, 2012					
Impaired loans	\$ 17,600	Appraisal of collateral (1)	Appraisal adjustments (2)	20.0% to -68.0%	(-32.4%)
			Liquidation expenses (2)	0.3% to -45.8%	(-2.1%)
Other real estate owned	\$ 1,846	Appraisal of collateral (1), (3)			

- (1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various level 3 inputs which are not identifiable.
- (2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.
- (3) Includes qualitative adjustments by management and estimated liquidation expenses.

The estimated fair value of the Company's financial instruments is as follows:

December 31, 2012					
	Carrying Value	Level I	Level II	Level III	Total Fair Value
	(in thousands)				
Financial assets:					
Cash and cash equivalents	\$ 45,346	\$ 45,346	\$ -	\$ -	\$ 45,346
Investment securities					
Available for sale	194,472	5	194,467	-	194,472
Net loans	400,654	-	-	390,206	390,206
Bank-owned life insurance	8,536	8,536	-	-	8,536
Federal Home Loan Bank stock	1,887	1,887	-	-	1,887
Accrued interest receivable	2,163	2,163	-	-	2,163
Financial liabilities:					
Deposits	\$ 593,335	\$ 396,582	\$ -	\$ 196,122	\$ 592,704
Short-term borrowings	6,538	6,538	-	-	6,538
Other borrowings	12,970	-	-	13,337	13,337
Accrued interest payable	492	492	-	-	492
December 31, 2011					
	Carrying Value	Level I	Level II	Level III	Total Fair Value
	(in thousands)				
Financial assets:					
Cash and cash equivalents	\$ 34,390	\$ 34,390	\$ -	\$ -	\$ 34,390
Investment securities					
Available for sale	193,977	5	193,972	-	193,977
Net loans	395,061	-	-	382,542	382,542
Bank-owned life insurance	8,257	8,257	-	-	8,257
Federal Home Loan Bank stock	1,887	1,887	-	-	1,887
Accrued interest receivable	2,234	2,234	-	-	2,234
Financial liabilities:					
Deposits	\$ 580,962	\$ 362,029	\$ -	\$ 225,149	\$ 587,178
Short-term borrowings	7,392	7,392	-	-	7,392
Other borrowings	16,831	-	-	17,327	17,327
Accrued interest payable	645	645	-	-	645

Financial instruments are defined as cash, evidence of ownership interest in an entity, or a contract which creates an obligation or right to receive or deliver cash or another financial instrument from/to a second entity on potentially favorable or unfavorable terms.

Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing parties other than in a forced liquidation sale. If a quoted market price is available for a financial instrument, the estimated fair value would be calculated based upon the market price per trading unit of the instrument.

If no readily available market exists, the fair value estimates for financial instruments should be based upon management's judgment regarding current economic conditions, interest rate risk, expected cash flows, future estimated losses, and other factors as determined through various option pricing formulas or simulation modeling. Since many of these assumptions result from judgments made by management based upon estimates which are inherently uncertain, the resulting estimated fair values may not be indicative of the amount realizable in the sale of a particular financial instrument. In addition, changes in assumptions on which the estimated fair values are based may have a significant impact on the resulting estimated fair values.

As certain assets such as deferred tax assets and premises and equipment are not considered financial instruments, the estimated fair value of financial instruments would not represent the full value of the Company.

The Company employed simulation modeling in determining the estimated fair value of financial instruments for which quoted market prices were not available based upon the following assumptions:

Cash and Cash Equivalents, Federal Home Loan Bank Stock, Accrued Interest Receivable, Accrued Interest Payable, and Short-Term Borrowings

The fair value is equal to the current carrying value.

Bank-Owned Life Insurance

The fair value is equal to the cash surrender value of the life insurance policies.

Investment Securities Available for Sale

The fair value of investment securities is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities. Fair value for certain private-label collateralized mortgage obligations were determined utilizing discounted cash flow models, due to the absence of a current market to provide reliable market quotes for the instruments.

Loans

The fair value is estimated by discounting future cash flows using current market inputs at which loans with similar terms and qualities would be made to borrowers of similar credit quality. Where quoted market prices were available, primarily for certain residential mortgage loans, such market rates were utilized as estimates for fair value.

Deposits and Other Borrowed Funds

The fair values of certificates of deposit and other borrowed funds are based on the discounted value of contractual cash flows. The discount rates are estimated using rates currently offered for similar instruments with similar remaining maturities. Demand, savings, and money market deposits are valued at the amount payable on demand as of year-end.

Commitments to Extend Credit

These financial instruments are generally not subject to sale, and estimated fair values are not readily available. The carrying value, represented by the net deferred fee arising from the unrecognized commitment or letter of credit, and the fair value, determined by discounting the remaining contractual fee over the term of the commitment using fees currently charged to enter into similar agreements with similar credit risk, are not considered material for disclosure. The contractual amounts of unfunded commitments and letters of credit are presented in Note 14.

18. COMMON STOCK OFFERING

In a private common stock offering that began in 2010, Middlefield Banc Corp. sold a total of 138,150 shares in 2011, followed by a sale of 93,050 shares on April 17, 2012 and a sale of 103,585 shares on April 30, 2012. The offering concluded on March 8, 2013 with a sale of 13,320 shares to an institutional investor, completing the sale to that investor under the terms of the subscription agreement it entered into in August of 2011. All sales in the offering occurred at \$16 per share.

19. PARENT COMPANY

Following are condensed financial statements for the Company.

CONDENSED BALANCE SHEET

(Dollar amounts in thousands)

	December 31,	
	2012	2011
ASSETS		
Cash and due from banks	\$ 1,740	\$ 710
Investment securities available for sale	751	751
Investment in non-bank subsidiary	2,664	2,944
Investment in subsidiary banks	62,002	55,256
Other assets	1,453	1,638
TOTAL ASSETS	\$ 68,610	\$ 61,299
LIABILITIES		
Trust preferred securities	\$ 8,248	\$ 8,248
Short-term borrowings	4,896	5,700
Other liabilities	29	98
TOTAL LIABILITIES	13,173	14,046
STOCKHOLDERS' EQUITY	55,437	47,253
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 68,610	\$ 61,299

CONDENSED STATEMENT OF INCOME

	Year Ended December 31,		
	2012	2011	2010
INCOME			
Dividends from subsidiary bank	\$ 2,327	\$ 2,403	\$ 2,061
Interest income	-	-	3
Other	8	(177)	17
Total income	2,335	2,226	2,081
EXPENSES			
Interest expense	417	772	773
Other	594	370	270
Total expenses	1,011	1,142	1,043
Income before income tax benefit	1,324	1,084	1,038
Income tax benefit	(342)	(449)	(348)
Income before equity in undistributed net income of subsidiaries	1,666	1,533	1,386
Equity in undistributed net income of subsidiaries	4,615	2,597	1,131
NET INCOME	\$ 6,281	\$ 4,130	\$ 2,517
Comprehensive Income	\$ 7,131	\$ 8,184	\$ 2,442

20. PARENT COMPANY

CONDENSED STATEMENT OF CASH FLOWS

(Dollar amounts in thousands)	Year Ended December 31,		
	2012	2011	2010
OPERATING ACTIVITIES			
Net income	\$ 6,281	\$ 4,130	\$ 2,517
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed net income of Middlefield Banking Company	(4,655)	(3,422)	(2,582)
Equity in undistributed net income of Emerald Bank	(240)	384	292
Equity in undistributed net income of EMORECO	280	441	1,159
Stock-based compensation expense	32	59	-
Investment securities losses, net	-	179	-
Other	(885)	(806)	(602)
Net cash provided by operating activities	<u>813</u>	<u>965</u>	<u>784</u>
INVESTING ACTIVITIES			
Investment in subsidiary bank	-	(1,500)	(500)
Net cash used for investing activities	<u>-</u>	<u>(1,500)</u>	<u>(500)</u>
FINANCING ACTIVITIES			
Net decrease in short-term borrowings	(804)	-	-
Common stock issued	2,329	2,210	-
Proceeds from dividend reinvestment plan	694	542	510
Cash dividends	(2,002)	(1,764)	(1,637)
Net cash provided by (used for) financing activities	<u>217</u>	<u>988</u>	<u>(1,127)</u>
Increase (decrease) in cash	1,030	453	(843)
CASH AT BEGINNING OF YEAR	<u>710</u>	<u>257</u>	<u>1,100</u>
CASH AT END OF YEAR	<u>\$ 1,740</u>	<u>\$ 710</u>	<u>\$ 257</u>

21. SELECTED QUARTERLY FINANCIAL DATA (Unaudited)

(Dollar amounts in thousands)

	Three Months Ended			
	March 31, 2012	June 30, 2012	September 30, 2012	December 31, 2012
Total interest income	\$ 7,232	\$ 7,223	\$ 7,342	\$ 6,949
Total interest expense	1,686	1,646	1,602	1,513
Net interest income	5,546	5,577	5,740	5,436
Provision for loan losses	600	450	143	975
Net interest income after provision for loan losses	4,946	5,127	5,597	4,461
Total noninterest income	794	1,017	868	772
Total noninterest expense	3,782	4,041	4,122	3,694
Income before income taxes	1,958	2,103	2,343	1,539
Income taxes	435	463	494	270
Net income	<u>\$ 1,523</u>	<u>\$ 1,640</u>	<u>\$ 1,849</u>	<u>\$ 1,269</u>
Per share data:				
Net income				
Basic	\$ 0.86	\$ 0.85	\$ 0.93	\$ 0.65
Diluted	0.86	0.85	0.93	0.64
Average shares outstanding:				
Basic	1,763,982	1,919,333	1,978,181	1,984,818
Diluted	1,764,585	1,921,205	1,983,863	1,991,354

(Dollar amounts in thousands)

	Three Months Ended			
	March 31, 2011	June 30, 2011	September 30, 2011	December 31, 2011
Total interest income	\$ 7,359	\$ 7,421	\$ 7,528	\$ 7,419
Total interest expense	2,341	2,304	2,134	1,873
Net interest income	5,018	5,117	5,394	5,546
Provision for loan losses	865	700	920	600
Net interest income after provision for loan losses	4,153	4,417	4,474	4,946
Total noninterest income	699	594	686	258
Total noninterest expense	3,705	4,292	3,906	3,598
Income before income taxes	1,147	719	1,254	1,606
Income taxes	145	(1)	175	277
Net income	<u>\$ 1,002</u>	<u>\$ 720</u>	<u>\$ 1,079</u>	<u>\$ 1,329</u>
Per share data:				
Net income				
Basic	\$ 0.62	\$ 0.44	\$ 0.63	\$ 0.76
Diluted	0.62	0.44	0.63	0.76
Average shares outstanding:				
Basic	1,621,889	1,647,771	1,704,677	1,756,157
Diluted	1,651,889	1,647,920	1,704,677	1,756,157

Management's Discussion and Analysis of

Financial Condition and Results of Operations

Overview

The consolidated review and analysis of Middlefield Banc Corp. ("Company") is intended to assist the reader in evaluating the performance of the Company for the years ended December 31, 2012, 2011, and 2010. This information should be read in conjunction with the consolidated financial statements and accompanying notes to the financial statements.

The Company is an Ohio corporation organized to become the holding company of The Middlefield Banking Company ("MBC"). MBC is a state-chartered bank located in Ohio. On April 19, 2007, the Company acquired Emerald Bank ("EB"), an Ohio-chartered commercial bank headquartered in Dublin, Ohio. On October 23, 2009, the Company established an asset resolution subsidiary named EMORECO, Inc. The Company and its two banking subsidiaries derive substantially all of their income from banking and bank-related services, which includes interest earnings on residential real estate, commercial mortgage, commercial and consumer financings as well as interest earnings on investment securities and deposit services to its customers through ten locations. The Company is supervised by the Board of Governors of the Federal Reserve System, while the Banks are subject to regulation and supervision by the Federal Deposit Insurance Corporation and the Ohio Division of Financial Institutions. MBC and EB are members of the Federal Home Loan Bank (FHLB) of Cincinnati, which is one of the twelve regional banks comprising the FHLB System.

This Management's Discussion and Analysis section of the Annual Report contains forward-looking statements. Forward-looking statements are based upon a variety of estimates and assumptions. The estimates and assumptions involve judgments about a number of things, including future economic, competitive, and financial market conditions and future business decisions. These matters are inherently subject to significant business, economic, and competitive uncertainties, all of which are difficult to predict and many of which are beyond the Company's control. Although the Company believes its estimates and assumptions are reasonable, actual results could vary materially from those shown. Inclusion of forward-looking information does not constitute a representation by the Company or any other person that the indicated results will be achieved. Investors are cautioned not to place undue reliance on forward-looking information.

These forward-looking statements may involve significant risks and uncertainties. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from the results in these forward-looking statements.

Significant Factors Affecting Financial Results

Formation of asset resolution subsidiary. On October 23, 2009 the Company received from the Federal Reserve Bank of Cleveland approval to establish an asset resolution subsidiary. Organized as an Ohio corporation under the name EMORECO, Inc. and wholly owned by the Company, the purpose of the asset resolution subsidiary is to maintain, manage, and ultimately dispose of nonperforming loans and real estate acquired by subsidiary banks as the result of borrower default on real-estate-secured loans. At December 31, 2012, EMORECO's assets consist of six nonperforming loans and eight OREO properties. EMORECO has paid approximately \$5.8 million to Emerald Bank for the nonperforming loans and other real estate, using funds contributed by the Company, which were borrowed under lines of credit of the holding company. Federal law governing bank holding companies provides that a holding company subsidiary has limited real estate investment powers. EMORECO may only manage and maintain property and may not improve or develop property without advance approval of the Federal Reserve Bank.

Closer regulatory supervision of Emerald Bank. In February of 2011 Emerald Bank agreed with the FDIC and the Ohio Division of Financial Institutions that Emerald Bank will take specified actions to correct weaknesses in the bank's condition and operations. The actions that Emerald Bank agreed to take include reducing the bank's concentration of credit in non-owner occupied 1 - 4 family residential mortgage loans, reducing delinquent and classified loans, enhancing credit administration for non-owner occupied residential real estate, developing plans for the reduction of borrower indebtedness on classified and delinquent credits, implementing an earnings improvement plan, maintaining leverage capital of at least 9%, revising the bank's methodology for calculating and determining the adequacy of the allowance for loan losses, and providing to the FDIC and the ODFI notice of proposed dividend payments at least 30 days in advance.

We have conducted an evaluation and reorganization of lending and credit administration personnel, retained collection and workout personnel, and sold \$5.8 million of nonperforming assets EMORECO, Inc., Middlefield Banc Corp.'s nonbank-asset resolution subsidiary established in the fourth quarter of 2009. Middlefield Banc Corp. provided capital of \$500,000 to Emerald Bank in 2010 and \$1.50 million in 2011 so that Emerald Bank would achieve the elevated 9% leverage capital level. At December 31, 2012 Emerald Bank's leverage ratio was 10.61%.

In addition to Emerald Bank maintaining leverage capital of at least 9%, The Middlefield Banking Company committed to the FDIC that The Middlefield Banking Company will maintain capital ratios at levels no lower than its June 30, 2010 ratios (*i.e.*, no lower than 6.25% tier 1 leverage capital and 11.29% total risk-based capital), and Middlefield Banc Corp. committed to the Federal Reserve that Middlefield Banc Corp. will maintain tier 1 leverage capital of at least 7.25% and total risk-based capital of at least 12%, both at the level of the holding company and at the level of The Middlefield Banking Company, the lead bank.

Continued weakness in the local and regional economies. In 2012 the Company continued to be impacted by the recession that began in late 2007, with sluggish local and regional economies, a depressed residential and commercial real estate market, and elevated unemployment levels. We currently anticipate that in the near term of the next year or two the economy of the markets in which we conduct business will remain sluggish at best. There is the potential for further deterioration in the residential and commercial real estate markets and in unemployment levels, but we currently are optimistic that within the next year or two these local and regional macro-economic factors could actually turn slightly positive. Nevertheless, we anticipate that prevailing interest rates will remain at historically low levels, with improvement in the level of nonperforming assets and classified assets lagging somewhat behind improvement in the local and regional economies. In the longer term of three to five years, we anticipate a more solid economy locally, regionally, and nationally, with interest rates finally increasing from their prolonged record-low levels.

Capital maintenance and enhancement is a priority. In January of 2011, the Company's board established a goal to achieve Tier 1 leverage capital of 7.25% and total risk-based capital of 12.00%, both at the level of the Company and at MBC. The parent company board also affirmed the goal of restraining growth at the level of the subsidiary banks to promote achievement of these elevated capital level targets. The Company's Tier 1 leverage capital was 7.88% as of December 31, 2012, with total risk-based capital of 13.86%. MBC's Tier 1 leverage capital was 7.32% as of December 31, 2012, with total risk-based capital of 13.29%. In 2012 MBC restrained asset growth by reducing the rates paid on deposits, which also had the effect of enhancing our net interest margin. We also benefitted from stable income, saw a large increase in unrecognized gains on securities, and raised additional equity capital in a private offering. These led to increased equity capital, resulting in overall improvement to the regulatory capital ratios of MBC and the Company. The goal of the elevated capital levels is to account for the ongoing economic stress in the markets in which the Company and its subsidiary banks operate and to account for the levels of substandard and other nonperforming assets.

In a private common stock offering that began in 2010, Middlefield Banc Corp. sold a total of 138,150 shares in 2011, followed by a sale of 93,050 shares on April 17, 2012 and a sale of 103,585 shares on April 30, 2012. The offering concluded on March 8, 2013 with a sale of 13,320 shares to an institutional investor, completing the sale to that investor under the terms of the subscription agreement it entered into in August of 2011. All sales in the offering occurred at \$16 per share. Although the private stock offering has ended, because of elevated regulatory capital requirements and increased levels of substandard and nonperforming assets we continue to monitor our capital closely and we continue to consider opportunities to enhance capital, whether by raising additional equity or otherwise.

On or about January 14, 2013 an investor to whom we sold a total of 196,635 shares in April of 2012, constituting 9.9% of our stock, obtained from the Ohio Division of Financial Institutions and the Federal Reserve Bank of Cleveland regulatory clearance to acquire up to 24.99% of our stock. The August 15, 2011 Stock Purchase Agreement, as amended, under which we sold shares to the investor provided for sale of up to 24.99% of our stock, subject to the investor obtaining regulatory clearance and subject to other conditions. Although we disclosed in a Form 8-K Current Report filed with the SEC on January 18, 2013 that sale of additional shares to the investor under the terms of the Stock Purchase Agreement will not occur, if the investor nevertheless acquires shares and increases his ownership to 10% or more of our common stock, whether acquiring the shares on the open market or from us, we will become subject to additional restrictions under the terms of the regulatory clearance issued to the investor by the Ohio Division of Financial Institutions. Specifically, for three years after the investor becomes an owner of 10% or more of our stock, we would have to obtain advance approval of the ODFI in order for The Middlefield Banking Company to pay a dividend to Middlefield Banc Corp., and for 12 months we would have to obtain advance written approval of the ODFI for any changes in the composition of Middlefield Banc Corp.'s board or executive management.

Longer-term prospects for growth. Capital enhancement and reduction of nonperforming assets are a higher priority than growth. The Company does not anticipate significant deposit growth, and the percentage of assets represented by the securities portfolio will continue to exceed historical levels until loan demand in the Company's markets recovers. An increase in loan demand and in the availability of high-quality lending opportunities depends on improvement in a broad range of economic factors in the markets in which the Company operates, including employment levels and the condition of the residential and commercial real estate markets in northeastern Ohio and in central Ohio.

The financial crisis that began at the end of 2007 has had a profound impact on the banking industry. More than 450 banks and savings associations have failed. The FDIC's list of problem institutions remains at an elevated level, with 694 problem institutions at the end of the third quarter of 2012. Nonperforming and classified assets held by the banking industry likewise remain at elevated levels. With continued economic stagnation, uncertainty about when the economy will fully recover and the strength of the recovery and the potential for other factors to have an adverse impact on the prospects for the banking industry, such as national and global economic and political factors, the bank regulatory agencies have insisted that banks increase the size of the buffer that protects a bank from unknown potential adverse events and circumstances: regulatory capital.

Under these conditions a bank's prospects for growth by expansion or other form of acquisition are limited by the more immediate need for additional capital or by the bank's obligation to ensure that expansion will not expose the bank to the risk of inadequate capital. In addition, the economic events of the last few years have very adversely affected bank valuations throughout the entire industry, with the entire industry burdened by excessive nonperforming and classified assets and the potential for still more growth in those asset classes. Much of the growth by acquisition or expansion that has occurred in the banking industry in recent years has consisted of FDIC-assisted acquisitions of failed institutions. We believe that as economic uncertainties are reduced, including uncertainty about whether the nonperforming and other classified assets will continue to grow or will instead finally be reduced to more historically normal levels, the opportunities for growth, including by acquisition of other institutions or by establishment or acquisition of branches, will increase significantly. We believe that until then most of the growth that will occur will consist of organic growth based on a bank's existing profile.

At approximately 7,000, the total number of banks and savings associations as of the end of 2012 is less than half the number at the end of 1990, when the number exceeded 15,000. Nevertheless, a large percentage of the 7,000 institutions that remain are small, community-oriented institutions, although the share of total banking assets that they control continues to decline. As an increasing share of the banking universe is occupied by the largest institutions, and taking into account economic, demographic, and technological changes and a greatly expanding regulatory burden, the future of banking favors larger institutions. We believe these factors create a strong incentive for growth through industry consolidation, meaning acquisition of smaller institutions by larger institutions and mergers of smaller institutions as a defense to competitive pressure from larger institutions. We therefore believe that industry consolidation is likely to continue and that the pace of consolidation could actually accelerate.

The trend toward consolidation would be most advantageous for financial institution organizations that have a surplus of capital, a strategy for growth, a strong financial profile, and few if any regulatory supervisory concerns, the ingredients of prompt regulatory approval that could be a significant competitive advantage in the market for financial institution mergers and acquisitions. Our goal is to acquire that advantage; although we give no assurance that our efforts to do so will succeed. We are committing significant resources to eliminating weaknesses in the performance and condition of Emerald Bank and The Middlefield Banking Company, we have moved nonperforming and substandard assets from Emerald Bank to an asset resolution subsidiary, we have agreed to elevated capital requirements for both banks and for the holding company and we have taken steps to achieve those elevated capital levels, we continue to invest resources both to resolve existing nonperforming and substandard assets and to prevent growth in those asset classes, and we have raised additional holding company capital through a private equity offering.

Although we currently are not exploring acquisition opportunities and although it is unrealistic to expect that we will grow by acquisition within the next 12 months, beyond that immediate future we are seeking to make Middlefield Banc Corp. eligible to grow by acquisition if a suitable opportunity arises. We give no assurance that we will be eligible or that there will arise an opportunity we consider to be appropriate.

Critical Accounting Policies

Allowance for loan losses. Arriving at an appropriate level of allowance for loan losses involves a high degree of judgment. The Company's allowance for loan losses provides for probable losses based upon evaluations of known and inherent risks in the loan portfolio.

Management uses historical information to assess the adequacy of the allowance for loan losses as well as the prevailing business environment, which is affected by changing economic conditions and various external factors and which may impact the portfolio in ways currently unforeseen. The allowance is increased by provisions for loan losses and by recoveries of loans previously charged-off and reduced by loans charged-off. For a full discussion of the Company's methodology of assessing the adequacy of the reserve for loan losses, refer to Note 1 of "Notes to Consolidated Financial Statements" of this Annual Report.

Valuation of Securities. Securities are classified as held-to-maturity or available-for-sale on the date of purchase. Only those securities classified as held-to-maturity are reported at amortized cost. Available-for-sale and trading securities are reported at fair value with unrealized gains and losses included in accumulated other comprehensive income, net of related deferred income taxes, on the Consolidated Balance Sheet. The fair value of a security is determined based on quoted market prices. If quoted market prices are not available, fair value is determined based on quoted prices of similar instruments. Realized securities gains or losses are reported within noninterest income in the Consolidated Statement of Income. The cost of securities sold is based on the specific identification method.

Management evaluates securities for other-than-temporary impairment ("OTTI") at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Investment securities are generally evaluated for OTTI under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 320, Investments — Debt and Equity Securities. Consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, whether the market decline was affected by macroeconomic conditions and whether the Company has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. In analyzing an issuer's financial condition, the Company may consider whether the securities are issued by the federal government or its agencies, or U.S. government-sponsored enterprises, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When OTTI occurs, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis. If an entity intends to sell or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, the OTTI shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income or loss. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

Debt securities issued by U.S. government agencies, U.S. government-sponsored enterprises, and state and political subdivisions accounted for more than 97.0 percent of the total available-for-sale portfolio as of December 31, 2012, and no credit losses are expected, given the explicit and implicit guarantees provided by the U.S. federal government and the lack of significant unrealized loss positions within the obligations of state and political subdivisions security portfolio. The Company considered the following factors in determining whether a credit loss exists and the period over which the debt security is expected to recover:

- The length of time and the extent to which the fair value has been less than the amortized cost basis.
- Changes in the near term prospects of the underlying collateral of a security such as changes in default rates, loss severity given default and significant changes in prepayment assumptions.

- The level of cash flows generated from the underlying collateral supporting the principal and interest payments of the debt securities.
- Any adverse change to the credit conditions and liquidity of the issuer, taking into consideration the latest information available about the overall financial condition of the issuer, credit ratings, recent legislation and government actions affecting the issuer's industry and actions taken by the issuer to deal with the present economic climate.

The Company's investment in one private-label collateralized mortgage obligation with a carrying value of \$899,000 was impaired in 2011 as a result of the Company's determination that declines in their fair value were other than temporary. As a result of this determination, the Company recognized a \$35,000 before-tax, non-cash charge, which was recorded as a reduction to noninterest income.

Refer to Note 5 in the consolidated financial statements.

Income Taxes

The Company estimates income tax expense based on amounts expected to be owed to the various tax jurisdictions in which the Company conducts business. On a quarterly basis, management assesses the reasonableness of its effective tax rate based upon its current estimate of the amount and components of net income, tax credits and the applicable statutory tax rates expected for the full year. The estimated income tax expense is recorded in the Consolidated Statement of Income.

Deferred income tax assets and liabilities are determined using the balance sheet method and are reported in accrued taxes, interest and expenses in the Consolidated Balance Sheet. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax basis of assets and liabilities and recognizes enacted changes in tax rates and laws. Deferred tax assets are recognized to the extent they exist and are subject to a valuation allowance based on management's judgment that realization is more-likely-than-not.

Accrued taxes represent the net estimated amount due to taxing jurisdictions and are reported in accrued taxes, interest and expenses in the Consolidated Balance Sheet. The Company evaluates and assesses the relative risks and appropriate tax treatment of transactions and filing positions after considering statutes, regulations, judicial precedent and other information and maintains tax accruals consistent with its evaluation of these relative risks and merits. Changes to the estimate of accrued taxes occur periodically due to changes in tax rates, interpretations of tax laws, the status of examinations being conducted by taxing authorities and changes to statutory, judicial and regulatory guidance that impact the relative risks of tax positions. These changes, when they occur, can affect deferred taxes and accrued taxes as well as the current period's income tax expense and can be significant to the operating results of the Company.

Goodwill and Other Intangible Assets

Goodwill is the excess of the purchase price over the fair value of the assets acquired in connection with business acquisitions accounted for as purchases. Other intangible assets consist of branch acquisition core deposit premiums.

The Company must assess goodwill and other intangible assets each year for impairment. The gross carrying amount of goodwill and intangible assets is tested for impairment in the fourth quarter, after the annual forecasting process.

Management's assessment of the carrying value of goodwill and intangible assets involves estimating cash flows for future periods. If the future cash flows were less than the recorded goodwill and other intangible assets balances, the Company would be required to take a charge against earnings to write down the assets to the lower value.

Fair Value of Financial Instruments

The disclosure of the fair value of financial instruments is based on available market prices or management's estimates of the fair value of such instruments.

Management consults with a third party for available market prices as well as performs calculations of the present value of contractual cash flows discounted at current comparative market inputs. Prepayment estimates are utilized when appropriate.

Changes in Financial Condition

General The Company's total assets increased \$15.8 million or 2.4% to \$670.3 million at December 31, 2012 from \$654.6 million at December 31, 2011. The increase was due to an increase in cash and due from banks of \$17.8 million and net loans receivable of \$5.6 million, which was partially offset by a decrease in federal funds sold of \$6.9 million.

The increase in the Company's total assets reflects a related increase in total liabilities of \$7.6 million or 1.2% to a total balance of \$614.9 million at December 31, 2012 from \$607.3 million at December 31, 2011. The Company also experienced an increase in total stockholders' equity of \$8.2 million.

The increase in total liabilities was primarily due to deposit growth for the year. Total deposits increased \$12.4 million or 2.1% to \$593.3 million at December 31, 2012 from \$581.0 million as of December 31, 2011. The net increase in total stockholders' equity can be attributed to increases in retained earnings of \$4.3 million, or 23.5% and common stock of \$3.1 million, or 9.8%.

Cash on hand and Federal funds sold Cash and due from banks, interest-earning deposits and federal funds sold represent cash and cash equivalents which increased \$11.0 million or 31.9% to \$45.3 million at December 31, 2012 from \$34.4 million at December 31, 2011. Deposits from customers into savings and checking accounts, loan and security repayments and proceeds from borrowed funds typically increase these accounts. Decreases result from customer withdrawals, new loan originations, security purchases and repayments of borrowed funds. The net increase in 2012 can be attributed to an increase in due from banks of \$17.9 million, or 113.4%.

Securities Management's objective in structuring the portfolio is to maintain a prudent level of liquidity while providing an acceptable rate of return without sacrificing asset quality. Maturing securities have historically provided sufficient liquidity. The balance of total securities increased \$495,000, or .3%, as compared to 2011, with the ratio of securities to total assets decreasing to 29.0% at December 31, 2012, compared to 29.6% at December 31, 2011.

The Company continues to benefit from owning mortgage-backed securities, which totaled \$76.2 million or 39.2% of the Company's total investment portfolio at December 31, 2012. The primary advantage of mortgage-backed securities has been the increased cash flows due to the more rapid (monthly) repayment of principal as compared to other types of investment securities, which deliver proceeds upon maturity or call date. The weighted average federal tax equivalent (FTE) yield on all debt securities at year-end 2012 was 4.21%, as compared to 4.72% at year-end 2011. While the Company's focus is to generate interest revenue primarily through loan growth, management will continue to invest excess funds in securities when opportunities arise.

The majority of all of the Company's securities are valued based on prices compiled by third party vendors using observable market data. However, certain securities are less actively traded and do not always have quoted market prices. The determination of their fair value, therefore, requires judgment, as this determination may require benchmarking to similar instruments or analyzing default and recovery rates. Examples include certain collateralized mortgage and debt obligations and high-yield debt securities.

Loans receivable The loans receivable category consists primarily of single family mortgage loans used to purchase or refinance personal residences located within the Company's market area and commercial real estate loans used to finance properties that are used in the borrowers' businesses or to finance investor-owned rental properties and commercial loans to finance the business operations and to a lesser extent construction and consumer loans. Net loans receivable increased \$5.6 million or 1.4% to \$400.7 million at December 31, 2012 from \$395.1 million at December 31, 2011. Included in this growth were increases in commercial real estate and commercial and industrial loans of \$7.2 and \$3.0 million, respectively. These increases were partially offset by a decrease of \$4.3 million in residential real estate loans.

The product mix in the loan portfolio is commercial loans equaling 15.2%, construction loans 5.5%, residential real estate loans 49.9%, commercial real estate loans 28.3% and consumer loans 1.0% at December 31, 2012 compared with 14.7%, 5.5%, 51.7%, 27.0% and 1.1%, respectively, at December 31, 2011.

Loans contributed 78.0% of total interest income in 2012 and 73.5% in 2011. The loan portfolio yield of 5.51% in 2012 was 76 basis points greater than the average yield for total interest earning assets. Management recognizes that while the loan portfolio holds some of the Company's highest yielding assets, it is inherently the most risky portfolio.

Accordingly, management attempts to balance credit risk versus return with conservative credit standards. Management has developed and maintains comprehensive underwriting guidelines and a loan review function that monitors credits during and after the approval process. Because of the Company's increased levels of nonperforming assets, management follows additional procedures to ensure MBC and EB obtain current borrower financial information annually throughout the life of the loan obligation.

To minimize risks associated with changes in the borrower's future repayment capacity, the Company generally requires scheduled periodic principal and interest payments on all types of loans and normally requires collateral.

The Company will continue to monitor the size of its loan portfolio growth during 2013. The Company's lending markets remain challenging and have impacted loan growth due to suppressed levels of loan originations in previous years. The Company anticipates total loan growth to be marginal, with volume to continue at a flat to moderate pace throughout 2013. The Company remains committed to sound underwriting practices without sacrificing asset quality and avoiding exposure to unnecessary risk that could weaken the credit quality of the portfolio.

FHLB stock. FHLB stock remained unchanged at \$1.9 million at December 31, 2012 when compared to the prior year.

Goodwill. Goodwill results from prior business acquisitions and represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is assessed annually for impairment and any such impairment is recognized in the period identified by a charge to earnings. In assessing goodwill for impairment, management estimates the fair value of the Company's banking subsidiary to which the goodwill relates. To arrive at fair value estimates management considers prices received upon sale of other banking institutions of similar size and with similar operating results. Purchase prices as a multiple of earnings, book value, tangible book value and deposits are considered and applied to the Company's banking subsidiary. The process of evaluating goodwill for impairment requires management to make significant estimates and judgments. The use of different estimates, judgments or approaches to estimate fair value could result in a different conclusion regarding impairment of goodwill. Based on the analysis, management has determined that there is no goodwill impairment.

The Company annually uses the services of an independent third party that is regarded in the banking industry as an expert in valuing core deposits and monitoring the ongoing value of core deposit intangibles and goodwill on an annual basis. Goodwill balances were unchanged in 2012.

Bank owned life insurance. Bank owned life insurance (BOLI) is universal life insurance, purchased by the Company, on the lives of the Company's officers. The beneficial aspects of these universal life insurance policies are tax-free earnings and a tax-free death benefit, which are realized by the Company as the owner of the policies. BOLI increased by \$279,000 to \$8.5 million as of December 31, 2012 from \$8.3 million at the end of 2011 as a result of the earnings of the underlying insurance policies.

Deposits. Interest-earning assets are funded generally by both interest-bearing and noninterest-bearing core deposits. Deposits are influenced by changes in interest rates, economic conditions and competition from other banks. The Company considers various sources when evaluating funding needs, including but not limited to deposits, which represented 96.8% of the Company's total funding sources at December 31, 2012. The deposit base consists of demand deposits, savings, money market accounts and time deposits. Total deposits increased \$12.4 million or 2.1% to \$593.3 million at December 31, 2012 from \$581.0 million at December 31, 2011.

Time deposits, particularly certificates of deposit ("CD's"), remain the largest source of funding for the Company's earning assets, making up 33.2% of total deposits. During 2012, time deposits decreased \$22.2 million, or 10.1%, from year-end 2011. This is primarily due to the historically low market interest rates on CD's causing customers to seek greater return or additional liquidity in other instruments.

Offsetting the decrease in time deposits was an increase in the Company's demand deposit balances, which were up \$20.6 million, or 17.3%, to finish at \$139.8 million at year-end 2012 as compared to \$119.2 million at year-end 2011. Also adding to the Company's deposit growth for the year were increases in savings and money market accounts of \$8.2 million and \$5.7 million, or 4.9% and 7.6%, respectively. The Company will continue to experience increased competition for deposits in its market areas, which could challenge net growth in its deposit balances. The Company will continue to evaluate its deposit portfolio mix to properly employ both retail and wholesale funds to support earning assets and minimize interest costs.

Borrowed funds. The Company uses short and long-term borrowings as another source of funding to benefit asset growth and liquidity needs. These borrowings primarily include FHLB advances, junior subordinated debt, lines of credit from other banks and repurchase agreement borrowings. Borrowed funds decreased \$4.7 million or 19.5% to \$19.5 million at December 31, 2012 from \$24.2 million at December 31, 2011. FHLB advances declined \$3.9 million with short-term borrowings decreasing \$854,000.

Stockholders' equity. The Company maintains a capital level that exceeds regulatory requirements as a margin of safety for its depositors and shareholders. All of the capital ratios exceeded the regulatory well capitalized guidelines. Emerald Bank has agreed with the FDIC and the Ohio Division of Financial Institutions to maintain tier 1 leverage capital of at least 9%, The Middlefield Banking Company committed to the FDIC that The Middlefield Banking Company will maintain capital ratios at levels no lower than its June 30, 2010 ratios (*i.e.*, no lower than 6.25% tier 1 leverage capital and 11.29% total risk-based capital), and Middlefield Banc Corp. committed to the Federal Reserve that Middlefield Banc Corp. will maintain tier 1 leverage capital of at least 7.25% and total risk-based capital of at least 12%, both at the level of the holding company and at the level of The Middlefield Banking Company, the lead bank. With improved earnings and with additional equity capital raised in 2011 and in 2012, we have achieved the enhanced capital goals. In a private common stock offering that began in 2010, we sold a total of 138,150 shares in 2011, followed by a sale of 93,050 shares on April 17, 2012 and a sale of 103,585 shares on April 30, 2012. The offering concluded on March 8, 2013 with a sale of 13,320 shares to an institutional investor, completing the sale to that investor under the terms of the subscription agreement it entered into in August of 2011. All sales in the offering occurred at \$16 per share.

Stockholders' equity totaled \$55.4 million at December 31, 2012, compared to \$47.3 million at December 31, 2011, which represents growth of 17.3%. Common stock increased \$3.1 million or 9.8% to \$34.3 million at December 31, 2012 from \$31.2 million at December 31, 2011. The Company maintains a dividend reinvestment and stock purchase plan. The plan allows shareholders to purchase additional shares of Company stock. A benefit of the plan is to permit the shareholders to reinvest cash dividends as well as make supplemental purchases without the usual payment of brokerage commissions. During 2012, shareholders invested more than \$692,000 through the dividend reinvestment and stock purchase plan. These proceeds resulted in the issuance of 31,537 new shares at an average price of \$21.95.

Contributing to the equity growth was a \$4.3 million increase in retained earnings resulting from net income, less cash dividends paid of \$2.0 million, or \$1.04 per share, year-to-date.

Average Balance Sheet and Yield/Rate Analysis. The following table sets forth, for the periods indicated, information concerning the total dollar amounts of interest income from interest-earning assets and the resultant average yields, the total dollar amounts of interest expense on interest-bearing liabilities and the resultant average costs, net interest income, interest rate spread and the net interest margin earned on average interest-earning assets. For purposes of this table, average balances are calculated using monthly averages and the average loan balances include non-accrual loans and exclude the allowance for loan losses, and interest income includes accretion of net deferred loan fees. Yields on tax-exempt securities (tax-exempt for federal income tax purposes) are shown on a fully tax equivalent basis utilizing a federal tax rate of 34%.

(Dollars in thousands)	For the Twelve Months Ended December 31,								
	2012			2011			2010		
	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost
Interest-earning assets:									
Loans receivable	\$407,154	\$ 22,418	5.51%	\$383,854	\$ 21,854	5.69%	\$362,239	\$ 21,084	5.82%
Investment securities (3)	183,507	6,185	4.21%	195,528	7,745	4.72%	177,377	7,835	5.19%
Interest-bearing deposits with other banks	46,306	143	0.31%	39,162	128	0.33%	32,466	175	0.54%
Total interest-earning assets	636,967	28,746	4.75%	618,544	29,727	5.05%	572,082	29,094	5.32%
Noninterest-earning assets	22,701			21,554			39,896		
Total assets	<u>\$659,668</u>			<u>\$640,098</u>			<u>\$611,978</u>		
Interest-bearing liabilities:									
Interest-bearing demand deposits	\$ 69,041	251	0.36%	\$ 62,918	326	0.52%	\$ 43,714	394	0.90%
Money market deposits	72,614	300	0.41%	74,565	601	0.81%	66,392	942	1.42%
Savings deposits	171,712	655	0.38%	159,479	1,185	0.74%	130,107	1,616	1.24%
Certificates of deposit	206,905	4,529	2.19%	225,715	5,355	2.37%	248,445	6,552	2.64%
Borrowings	22,611	719	3.18%	25,521	1,185	4.64%	30,865	1,441	4.67%
Total interest-bearing liabilities	542,883	6,454	1.19%	548,198	8,653	1.58%	519,522	10,945	2.11%
Noninterest-bearing liabilities									
Other liabilities	64,355			51,556			53,350		
Stockholders' equity	52,430			40,344			39,105		
Total liabilities and stockholders' equity	<u>\$659,668</u>			<u>\$640,098</u>			<u>\$611,978</u>		
Net interest income		<u>\$ 22,292</u>			<u>\$ 21,074</u>			<u>\$ 18,149</u>	
Interest rate spread (1)			3.56%			3.47%			3.22%
Net interest margin (2)			3.74%			3.65%			3.41%
Ratio of average interest-earning assets to average interest-bearing liabilities			117.33%			112.83%			110.12%

- (1) Interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities
- (2) Net interest margin represents net interest income as a percentage of average interest-earning assets.
- (3) Tax equivalent adjustments to interest income for tax-exempt securities was \$1,533, \$1,485, and \$1,365 for 2012, 2011, and 2010, respectively.

INTEREST RATES AND INTEREST DIFFERENTIAL

(Dollars in thousands)	2012 versus 2011			2011 versus 2010		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
Interest-earning assets:						
Loans receivable	\$ 1,305	\$ (741)	\$ 564	\$ 1,244	\$ (474)	\$ 770
Investment securities	(537)	(1,023)	(1,560)	899	(989)	(90)
Interest-bearing deposits with other banks	23	(8)	15	29	(76)	(47)
Total interest-earning assets	791	(1,772)	(981)	2,172	(1,539)	633
Interest-bearing liabilities:						
Interest-bearing demand deposits	27	(102)	(75)	136	(204)	(68)
Money market deposits	(12)	(290)	(302)	91	(431)	(340)
Savings deposits	69	(599)	(530)	292	(722)	(431)
Certificates of deposit	(429)	(397)	(826)	(569)	(627)	(1,197)
Borrowings	(114)	(352)	(466)	(249)	(7)	(256)
Total interest-bearing liabilities	(459)	(1,740)	(2,199)	(299)	(1,993)	(2,292)
Net interest income	<u>\$ 1,250</u>	<u>\$ (32)</u>	<u>\$ 1,218</u>	<u>\$ 2,472</u>	<u>\$ 453</u>	<u>\$ 2,925</u>

Changes in Results of Operations

2012 Results Compared to 2011 Results

General The Company posted net income of \$6.3 million, compared to \$4.1 million for the year ended December 31, 2011. On a per share basis, 2012 earnings were \$3.28 per diluted share, representing an increase from the \$2.45 per diluted share for the year ended December 31, 2011. The return on average equity for the year ended December 31, 2012, was 11.98% and the Company's return on average assets was 0.95%. The \$2.2 million or 52.1% improvement in net income between 2012 and 2011 can be attributed to a decrease in total interest expense of \$2.2 million. This was partially offset by a decrease in total interest income of \$981,000.

Net interest income Net interest income, which is the Company's largest revenue source, is the difference between interest income on earning assets and interest expense paid on liabilities. Net interest income is affected by the changes in interest rates and the composition of interest-earning assets and interest-bearing liabilities. Net interest income increased by \$1.2 million in 2012 to \$22.3 million compared to \$21.1 million for 2011. This increase is the net result of a \$2.2 million decrease in interest expense which was partially offset by a decrease in interest income of \$981,000. Interest-earning assets averaged \$637.0 million during 2012 representing a \$18.4 million or 3.0% increase since year-end 2011. The Company's average interest-bearing liabilities decreased 5.5% from \$548.2 million in 2011 to \$542.9 million in 2012.

The profit margin, or spread, on invested funds is a key performance measure. The Company monitors two key performance indicators — net interest spread and net interest margin. The net interest spread represents the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities. The net interest margin represents the overall profit margin: net interest income as a percentage of total interest-earning assets. This performance indicator gives effect to interest earned for all investable funds including the substantial volume of interest-free funds. For 2012 the net interest margin, measured on a fully taxable equivalent basis, increased to 3.74%, compared to 3.65% in 2011.

Interest income Interest income decreased \$981,000 to \$28.7 million for 2012 which is attributable to a \$1.7 million decrease in taxable interest on investment securities. The change in interest income on securities was the result of a decrease in the average balance of investment securities and a lower yield on the portfolio. The average balance of investment securities decreased by \$12.0 million or 6.2% to \$183.5 million for the year ended December 31, 2012 as compared to \$195.5 million for the year ended December 31, 2011. The investment security yield fell to 4.21% for 2012, from 4.72% in 2011.

Interest and fees on loans increased \$564,000 to \$22.4 million for 2012, compared to \$21.9 million for 2011. This increase is attributable to the growth of the average balance of loans of \$23.3 million to \$407.2 million for the year ended December 31, 2012 as compared to \$383.9 million for the year ended December 31, 2011 which was offset by a decline in the loan yield to 5.51% for 2012, compared to 5.69% for 2011.

Interest expense Interest expense decreased \$2.2 million or 25.5% to \$6.5 million for 2012, compared with \$8.7 million for 2011. This change in interest expense can be attributed to a 39 basis point decline in the rate paid on these liabilities, as well as a decrease in the average balance of interest-bearing liabilities. For the year ended December 31, 2012 the average balance of interest-bearing liabilities decreased by \$5.3 million to \$542.9 million as compared to \$548.2 million for the year ended December 31, 2011. Interest incurred on deposits declined by \$1.8 million for the year from \$7.5 million in 2011 to \$5.7 million for year-end 2012. The change in deposit expense was due to a 33 basis point decline during the year and a decrease in the average balance of \$2.4 million in 2012. Interest expense incurred on FHLB advances, repurchase agreements, junior subordinated debt and other borrowings declined \$466,000 or 39.3% to \$719,000 for 2012, compared to \$1.2 million for 2011. The decline was compounded by a 146 basis point decrease in the rate paid on these borrowings during the year.

Loan Loss Provision The provision for loan losses is an operating expense recorded to maintain the related balance sheet allowance for loan losses at an amount considered adequate to cover probable losses incurred in the normal course of lending. The provision for loan losses for the year ended December 31, 2012 was \$2.2 million compared to \$3.1 million in 2011. The loan loss provision is based upon management's assessment of a variety of factors, including types and amounts of non-performing loans, historical loss experience, collectability of collateral values and guaranties, pending legal action for collection of loans and related guaranties, and current economic conditions. The loan loss provision reflects management's judgment of the current period cost-of-credit risk inherent in the loan portfolio. Although management believes the loan loss provision has been sufficient to maintain an adequate allowance for loan losses, actual loan losses could exceed the amounts that have been charged to operations.

The ratio of the allowance for loan losses to total loans increased to 1.90% of total loans at December 31, 2012 compared to the 1.70% at December 31, 2011. During the fourth quarter of 2009, the Company created a new entity, EMORECO, Inc., which is designed to aid in troubled asset resolution. Since its inception, EMORECO has purchased \$5.8 million of non-performing assets from EB, \$209,000 coming in 2012.

Non-interest income Non-interest income increased \$1.2 million or 54.3% to \$3.4 million for 2012 compared to \$2.2 million for 2011. The increase is largely due to increases in investment security gains and service charges on deposit accounts of \$783,000 and \$253,000, respectively.

Non-interest expense Operating expenses increased \$138,000, or .9% to \$15.6 million for 2012 compared to \$15.5 million for 2011. Equipment expense, professional fees, and Ohio franchise tax increased \$203,000, \$148,000, and \$129,000, or 36.5%, 18.5%, and 28.0%, respectively. Other expenses increased to \$3.7 million, up \$397,000 or 11.9% compared to the 2011 balance of \$3.3 million. Included in this amount are miscellaneous expenses related to other real estate owned which totaled \$376,000. This increase of \$226,000, a 150.6% increase over the prior year, stems largely from EMORECO activities relating to loans and OREO such as purchases from EB, write-downs, and OREO maintenance. FDIC insurance expense decreased \$479,000, or 49.6%, as management continues to monitor the related accrual method. Losses on the sale of other real estate owned decreased \$239,000 or 48.1% to \$258,000 when compared to the prior year. This decrease reflects a normalizing of the Company's sales of other real estate owned properties and the conservative approach in original valuation of these properties.

Provision for Income Taxes The provision for income taxes increased \$1.1 million to \$1.7 million for 2012, compared to a tax benefit of \$596,000 in 2011. This increase was due to an increase in pretax income of \$3.2 million during 2012. The Company's effective federal income tax rate in 2012 was 20.9% compared to 12.6% in 2011.

Changes in Results of Operations

2011 Results Compared to 2010 Results

General The Company posted net income of \$4.1 million, compared to \$2.5 million for the year ended December 31, 2010. On a per share basis, 2011 earnings were \$2.45 per diluted share, representing an increase from the \$1.60 per diluted share for the year ended December 31, 2010. The return on average equity for the year ended December 31, 2011, was 10.24% and the Company's return on average assets was 0.65%. The \$1.6 million or 64.1% improvement in net income between 2011 and 2010 can be attributed to a decrease in total interest expense of \$2.3 million.

Net interest income Net interest income, which is the Company's largest revenue source, is the difference between interest income on earning assets and interest expense paid on liabilities. Net interest income is affected by the changes in interest rates and the composition of interest-earning assets and interest-bearing liabilities. Net interest income increased by \$2.9 million in 2011 to \$21.1 million compared to \$18.1 million for 2010. This increase is the net result of a \$2.3 million decrease in interest expense which was supported by an increase in interest income of \$633,000. Interest-earning assets averaged \$618.5 million during 2011 representing a \$46.5 million or 8.1% increase since year-end 2010. The Company's average interest-bearing liabilities increased 5.5% from \$519.5 million in 2010 to \$548.2 million in 2011.

The profit margin, or spread, on invested funds is a key performance measure. The Company monitors two key performance indicators—net interest spread and net interest margin. The net interest spread represents the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities. The net interest margin represents the overall profit margin: net interest income as a percentage of total interest-earning assets. This performance indicator gives effect to interest earned for all investable funds including the substantial volume of interest-free funds. For 2011 the net interest margin, measured on a fully taxable equivalent basis, increased to 3.65%, compared to 3.41% in 2010.

Interest income Interest income increased \$633,000 to \$29.7 million for 2011 which was partially attributed to a \$770,000 increase in interest and fees on loans. The change in interest income on securities was the net result of an increase in the average balance of investment securities which was offset by a lower yield on the portfolio. The average balance of investment securities increased by \$18.1 million or 10.2% to \$195.5 million for the year ended December 31, 2011 as compared to \$177.4 million for the year ended December 31, 2010. The additional interest income earned due to growth was offset by a decline in the investment security yield to 4.72% for 2011, compared to 5.19% for 2010.

Interest and fees on loans increased \$770,000 to \$21.9 million for 2011, compared to \$21.1 million for 2010. This increase was primarily attributable to the growth of the average balance of loans of \$21.6 million to \$383.9 million for the year ended December 31, 2011 as compared to \$362.2 million for the year ended December 31, 2010 which was offset by a decline in the loan yield to 5.69% for 2011, compared to 5.82% for 2010. This decline was due to the fact that a large percentage of the loan portfolio uses the prime rate as its index. Loans continued to reprice to the historically low 3.25% prime rate throughout 2011.

Interest expense Interest expense decreased \$2.3 million or 21.0% to \$8.7 million for 2011, compared with \$10.9 million for 2010. This change in interest expense can be attributed to a 53 basis point decline in the rate paid on these liabilities, partially offset by an increase in the average balance of interest-bearing liabilities. For the year ended December 31, 2011 the average balance of interest-bearing liabilities grew by \$28.7 million to \$548.2 million as compared to \$519.5 million for the year ended December 31, 2010. Interest incurred on deposits declined by \$2.0 million for the year from \$9.5 million in 2009 to \$7.5 million for year-end 2011. The change in deposit expense was due to a 51 basis point decline during the year which was partially offset by an increase in the average balance of \$34.0 million in 2011. Interest expense incurred on FHLB advances, repurchase agreements, junior subordinated debt and other borrowings declined \$256,000 or 17.8% to \$1.2 million for 2011, compared to \$1.4 million for 2010. The decline was slightly more profound by a 3 basis point decrease in the rate paid on these borrowings during the year.

Loan Loss Provision —The provision for loan losses is an operating expense recorded to maintain the related balance sheet allowance for loan losses at an amount considered adequate to cover probable losses incurred in the normal course of lending. The provision for loan losses for the year ended December 31, 2011 was \$3.1 million compared to \$3.6 million in 2010. The loan loss provision is based upon management's assessment of a variety of factors, including types and amounts of non-performing loans, historical loss experience, collectability of collateral values and guaranties, pending legal action for collection of loans and related guaranties, and current economic conditions. The loan loss

provision reflects management's judgment of the current period cost-of-credit risk inherent in the loan portfolio. Although management believes the loan loss provision has been sufficient to maintain an adequate allowance for loan losses, actual loan losses could exceed the amounts that have been charged to operations.

The ratio of the allowance for loan losses to total loans increased to 1.70% of total loans at December 31, 2011 compared to the 1.67% at December 31, 2010. During the fourth quarter of 2009, the Company created a new entity, EMORECO, Inc., which is designed to aid in troubled asset resolution. Since its inception, EMORECO has purchased \$5.8 million of non-performing assets from EB, \$957,000 coming in 2011.

Non-interest income Non-interest income decreased \$386,000 or 14.7% to \$2.2 million for 2011 compared to \$2.6 million for 2010. The decrease is due to a reduction in service charges on deposit accounts of \$272,000 and investment security losses of \$194,000. The decline in service charges is the result of changes in federal regulations regarding the collection of overdraft fees while the security losses were mostly due to other than temporary impairment losses to equity securities. These were partially offset by increases in revenue from investment services of \$41,000 and rental income from OREO owned of \$34,000.

Non-interest expense Operating expenses increased \$738,000, or 5.0% to \$15.5 million for 2011 compared to \$14.8 million for 2010. Expense increases in salaries and employee benefits of \$822,000 were largely the result of the addition of employees due to the growth of the Company and increases in employees' health benefits. Professional fees increased \$122,000, or 18.0%, as management continues to explore avenues of decreased risk by leveraging outside resources. Additionally the Company recognized an increase in the Ohio state franchise tax of \$113,000 when compared to 2010. Other expenses increased to \$3.3 million, up \$280,000 or 9.1% compared to the 2010 balance of \$3.1 million. Included in this amount are expenses related to delinquent loans, foreclosures and OREO which totaled \$596,000 an increase of \$31,000 over the prior year which represents 11.1% of the increase. EMORECO had \$123,000 in loan and OREO expenses in 2011. Based on the number of non-performing loans management believes that the higher than historic expenses related to asset quality will continue into 2012. Losses on the sale of OREO decreased \$286,000 or 36.5% to \$497,000 when compared to the prior year. This decrease reflects a normalizing of the Company's sales of OREO properties and the conservative approach in original valuation of these properties. Included in this total is the Company's non-bank asset resolution subsidiary, EMORECO, which had \$455,000 in losses on the sale of OREO.

Provision for Income Taxes The provision for income taxes increased \$684,000 to \$596,000 for 2011, compared to a tax benefit of \$88,000 in 2010. This increase was due to an increase in pretax income of \$2.3 million during 2011. This increase was offset by the increase in non-taxable income from obligations of states and political subdivisions to \$2.9 million, an increase of \$233,000 when compared to 2010. The Company's effective federal income tax rate in 2011 was 12.6% compared to (3.6%) in 2010.

Asset and Liability Management

The primary objective of the Company's asset and liability management function is to maximize the Company's net interest income while simultaneously maintaining an acceptable level of interest rate risk given the Company's operating environment, capital and liquidity requirements, performance objectives and overall business focus. The principal determinant of the exposure of the Company's earnings to interest rate risk is the timing difference between the re-pricing or maturity of interest-earning assets and the re-pricing or maturity of its interest-bearing liabilities. The Company's asset and liability management policies are designed to decrease interest rate sensitivity primarily by shortening the maturities of interest-earning assets while at the same time extending the maturities of interest-bearing liabilities. The Board of Directors of the Company continues to believe in a strong asset/liability management process in order to insulate the Company from material and prolonged increases in interest rates. As a result of this policy, the Company emphasizes a larger, more diversified portfolio of residential mortgage loans in the form of mortgage-backed securities. Mortgage-backed securities generally increase the quality of the Company's assets by virtue of the insurance or guarantees that back them, are more liquid than individual mortgage loans and may be used to collateralize borrowings or other obligations of the Company.

The Company's Board of Directors has established an Asset and Liability Management Committee consisting of outside directors and senior management. This committee, which meets quarterly, generally monitors various asset and liability management policies and strategies.

Interest Rate Sensitivity Simulation Analysis

The Company utilizes income simulation modeling in measuring its interest rate risk and managing its interest rate sensitivity. The Asset and Liability Management Committee of the Company believes the various rate scenarios of the simulation modeling enables the Company to more accurately evaluate and manage the exposure of interest rate fluctuations on net interest income, the yield curve, various loan and mortgage-backed security prepayments, and deposit decay assumptions.

Earnings simulation modeling and assumptions about the timing and volatility of cash flows are critical in net portfolio equity valuation analysis. Particularly important are the assumptions driving mortgage prepayments and expected attrition of the core deposit portfolios. These assumptions are based on the Company's historical experience and industry standards and are applied consistently across all rate risk measures.

The Company has established the following guidelines for assessing interest rate risk:

Net interest income simulation- Given a 200 basis point parallel gradual increase or decrease in market interest rates, net interest income may not change by more than 10% for a one-year period.

Portfolio equity simulation- Portfolio equity is the net present value of the Company's existing assets and liabilities. Given a 200 basis point immediate and permanent increase or decrease in market interest rates, portfolio equity may not correspondingly decrease or increase by more than 20% of stockholders' equity.

The following table presents the simulated impact of a 200 basis point upward or downward shift of market interest rates on net interest income, and the change in portfolio equity. This analysis was done assuming the interest-earning asset and interest-bearing liability levels at December 31, 2012 remained constant. The impact of the market rate movements was developed by simulating the effects of rates changing gradually over a one-year period from the December 31, 2012 levels for net interest income, and portfolio equity. The impact of market rate movements was developed by simulating the effects of an immediate and permanent change in rates at December 31, 2012 for portfolio equity:

	Increase 200 Basis Points	Decrease 200 Basis Points
Net interest income - increase (decrease)	(0.28)%	0.22%
Portfolio equity - increase (decrease)	(16.65)%	(5.80)%

Allowance for Loan Losses. The allowance for loan losses (ALL) represents the amount management estimates are adequate to provide for probable losses inherent in the loan portfolio as of the balance sheet date. Accordingly, all loan losses are charged to the allowance, and all recoveries credited to it. The ALL is established through a provision for loan losses, which is charged to operations. The provision is based on management's periodic evaluation of the adequacy of the ALL, taking into account the overall risk characteristics of the various portfolio segments, the Company's loan loss experience, the impact of economic conditions on borrowers, and other relevant factors. The estimates used to determine the adequacy of the ALL, including the amounts and timing of future cash flows expected on impaired loans, are particularly susceptible to significant change in the near term. The total ALL is a combination of a specific allowance for identified problem loans and a general allowance for homogeneous loan pools.

In 2012, the combination of relative weakness in commercial real estate values and a sluggish economy continued to have an adverse impact on the financial condition of commercial borrowers. Management does see continuing signs that the local economic environment has stabilized and that certain industries, specifically timber and construction, within our defined market area have experienced some improvement. Though economic improvement is noted, it has not been for a period of time sufficient to warrant the medium-term outlook, as it relates to the ALL and the qualitative factors found therein.

The allowance for loan loss balance as of December 31, 2012 totaled \$7.8 million representing a \$960,000 increase from the end of 2011. For the year of 2012, the provision for loan losses was \$2.2 million which represented a decrease of \$917,000 from the \$3.1 million provided during 2011. The provision for 2012 is reflective of the slightly positive trend in the decrease in non-performing loans. Asset quality is a high-priority in our overall business plan as it relates to long-

term asset growth projections. During 2012, net charge-offs decreased by \$1.3 million to \$1.2 million compared to \$2.5 million in 2011, signifying a favorable trend. Two key ratios to monitor asset quality performance are net charge-offs/average loans and the allowance for loan losses/non-performing loans. At year-end 2012, these ratios were .30% and 54.8%, respectively, compared to .65% and 27.8% in 2011.

The specific allowance incorporates the results of measuring impaired loans. The formula allowance is calculated by applying loss factors to outstanding loans by type, excluding loans for which a specific allowance has been determined. Loss factors are based on management's determination of the amounts necessary for concentrations and changes in mix and volume of the loan portfolio, and consideration of historical loss experience.

The non-specific allowance is determined based upon management's evaluation of existing economic and business conditions affecting the key lending areas of the Company and other conditions, such as new loan products, credit quality trends, collateral values, unique industry conditions within portfolio segments that existed as of the balance sheet date, and the impact of those conditions on the collectability of the loan portfolio. Management reviews these conditions quarterly. The non-specific allowance is subject to a higher degree of uncertainty because it considers risk factors that may not be reflected in the historical loss factors.

Although management uses the best information available to make the determination of the adequacy of the ALL at December 31, 2012, future adjustments could be necessary if circumstances or economic conditions differ substantially from the assumptions used in making the initial determinations. A downturn in the local economy and employment could result in increased levels of non-performing assets and charge-offs, increased loan loss provisions, and reductions in income. Additionally, as an integral part of the examination process, bank regulatory agencies periodically review a Company's ALL. The banking agencies could require the recognition of additions to the loan loss allowance based on their judgment of information available to them at the time of their examination.

The following table sets forth information concerning the Company's ALL at the dates and for the periods presented.

(Dollars in thousands)	For the Years Ended December 31,		
	2012	2011	2010
Allowance balance at beginning of period	\$ 6,819	\$ 6,221	\$ 4,937
Loans charged off:			
Commercial and industrial	(230)	(568)	(450)
Real estate-construction	(135)	(6)	-
Real estate-mortgage:			
Residential	(785)	(1,862)	(1,433)
Commercial	(123)	(265)	(428)
Consumer installment	(64)	(11)	(59)
Total loans charged off	(1,337)	(2,712)	(2,370)
Recoveries of loans previously charged-off:			
Commercial and industrial	71	76	40
Real estate-construction	-	-	-
Real estate-mortgage:			
Residential	31	122	-
Commercial	-	-	-
Consumer installment	27	27	34
Total recoveries	129	225	74
Net loans charged off	(1,208)	(2,487)	(2,296)
Provision for loan losses	2,168	3,085	3,580
Allowance balance at end of period	<u>\$ 7,779</u>	<u>\$ 6,819</u>	<u>\$ 6,221</u>
Loans outstanding:			
Average	\$ 407,154	\$ 383,854	\$ 362,239
End of period	408,433	401,880	372,498
Ratio of allowance for loan losses to loans outstanding at end of period	1.90%	1.70%	1.67
Net charge offs to average loans	(0.30)	(0.65)	(0.63)

The following table illustrates the allocation of the Company's allowance for probable loan losses for each category of loan for each reported period. The allocation of the allowance to each category is not necessarily indicative of future loss in a particular category and does not restrict our use of the allowance to absorb losses in other loan categories.

At December 31,						
2012		2011		2010		
Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	
(Dollars in Thousands)						
<u>Type of Loans:</u>						
Commercial and industrial	\$ 1,732 15.2%	\$ 1,296 14.7%	\$ 1,234 15.4%			
Real estate construction	1,123 5.5	438 5.4	356 4.3			
<u>Mortgage:</u>						
Residential	2,872 49.9	3,731 51.8	3,392 56.4			
Commercial	1,991 28.3	1,306 27.0	1,143 22.6			
Consumer installment	61 1.0	48 1.1	96 1.3			
Total	<u>\$ 7,779 100.0%</u>	<u>\$ 6,819 100.0%</u>	<u>\$ 6,221 100.0%</u>			

Non-performing assets. Non-performing assets includes non-accrual loans, troubled debt restructurings (TDRs), loans 90 days or more past due, assets purchased by EMORECO from EB, OREO, and repossessed assets. A loan is classified as non-accrual when, in the opinion of management, there are serious doubts about collectability of interest and principal. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions, the borrower's financial condition is such that collection of principal and interest is doubtful. Payments received on nonaccrual loans are applied against principal according to management's shadow accounting system.

TDRs are those loans which the Company, for economic or legal reasons related to a borrower's financial difficulties, grants a concession to the borrower that the Company would not otherwise consider. The Company has 49 TDRs with a total balance of \$4.7 million as of December 31, 2012 compared to 40 TDRs totaling \$10.0 million as of December 31, 2011. Non-performing loans amounted to \$14.2 million or 3.5% of total loans and \$25.1 million or 6.3% of total loans at December 31, 2012 and December 31, 2011, respectively. Non-performing loans secured by real estate totaled \$12.8 million as of December 31, 2012, a decrease of \$10.0 million from \$22.8 million at December 31, 2011. OREO is initially recorded at fair value and continually monitored for accurate valuation.

A major factor in determining the appropriateness of the ALL is the type of collateral which secures the loans. Of the total nonperforming loans at December 31, 2012, 90.2% were secured by real estate. Although this does not insure against all losses, the real estate provides substantial recovery, even in a distressed-sale and declining-value environment. In response to the poor economic conditions which have eroded the performance of the Company's loan portfolio, additional resources have been allocated to the loan workout process. The Company's objective is to work with the borrower to minimize the burden of the debt service and to minimize the future loss exposure to the Company.

The following table summarizes nonperforming assets by category.

	At December 31,		
	2012	2011	2010
	(Dollars in Thousands)		
Loans accounted for on a nonaccrual basis:			
Commercial and industrial	\$ 560	\$ 1,576	\$ 2,540
Real estate-construction	364	663	648
Real estate-mortgage:			
Residential	8,329	10,645	11,686
Commercial	2,105	3,921	3,513
Consumer installment	18	-	12
Total nonaccrual loans	<u>11,376</u>	<u>16,805</u>	<u>18,399</u>
Troubled debt restructuring:			
Commercial and industrial	503	778	619
Real estate-construction	-	3,883	-
Real estate-mortgage:			
Residential	1,250	797	530
Commercial	617	1,940	428
Consumer installment	11	24	10
Total troubled debt restructuring	<u>2,381</u>	<u>7,422</u>	<u>1,587</u>
Accruing loans which are contractually past due 90 days or more:			
Commercial and industrial	348	44	-
Real estate-construction	-	-	-
Real estate-mortgage:			
Residential	89	275	-
Commercial	-	-	-
Consumer installment	-	-	-
Total accruing loans which are contractually past due 90 days or more	<u>437</u>	<u>319</u>	<u>-</u>
Total non - performing loans	<u>14,194</u>	<u>24,546</u>	<u>19,986</u>
Other real estate owned	1,846	2,196	2,302
Total non-performing assets	<u>\$ 16,040</u>	<u>\$ 26,742</u>	<u>\$ 22,288</u>
Total non-performing loans to total loans	<u>3.48%</u>	<u>6.11%</u>	<u>5.37%</u>
Total non-performing loans to total assets	<u>2.12%</u>	<u>3.75%</u>	<u>3.16%</u>
Total non-performing assets to total assets	<u>2.39%</u>	<u>4.09%</u>	<u>3.53%</u>

Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions, the borrower's financial condition is such that collection of interest is doubtful. Payments received on non-accrual loans are recorded as income or applied against principal according to management's judgment as to the collectability of principal.

A loan is considered impaired when it is probable the borrower will not repay the loan according to the original contractual terms of the loan agreement, including all troubled debt restructurings. Management has determined that first mortgage loans on one-to-four family properties and all consumer loans represent large groups of smaller-balance homogeneous loans that are to be collectively evaluated. Loans that experience insignificant payment delays, which are defined as 90 days or less, generally are not classified as impaired. A loan is not impaired during a period of delay in payment if the Company expects to collect all amounts due, including interest accrued at the contractual interest rate for the period of delay. Management evaluates all loans identified as impaired individually. The Company estimates credit losses on impaired loans based on the present value of expected cash flows, or the fair value of the underlying collateral if loan repayment is expected to come from the sale or operation of the collateral. Impaired loans, or portions thereof, are charged off when it is determined a realized loss has occurred. Until that time, an allowance for loan loss is maintained for estimated losses.

Interest income that would have been recorded had these loans not been placed on nonaccrual status was \$756,000 in 2012; \$859,000 in 2011; and \$470,000 in 2010. Management is not aware of any trends or uncertainties related to any loans classified as doubtful or substandard that might have a material effect on earnings, liquidity, or capital resources.

Liquidity and Capital Resources

Liquidity. Liquidity management involves monitoring the ability to meet the cash flow needs of bank customers, such as borrowings or deposit withdrawals, as well as the Company's own financial commitments. The principal sources of liquidity are net income, loan payments, maturing and principal reductions on securities and sales of securities available for sale, federal funds sold and cash and deposits with banks. Along with its liquid assets, the Company has additional sources of liquidity available to ensure adequate funds are available as needed. These include, but are not limited to, the purchase of federal funds, the ability to borrow funds under line of credit agreements with correspondent banks, a borrowing agreement with the Federal Home Loan Bank of Cincinnati, Ohio and the adjustment of interest rates to obtain deposits. Management believes the Company has the capital adequacy, profitability and reputation to meet the current and projected needs of its customers.

Liquidity is managed based on factors including core deposits as a percentage of total deposits, the level of funding source diversification, the allocation and amount of deposits among deposit types, the short-term funding sources used to fund assets, the amount of non-deposit funding used to fund assets, the availability of unused funding sources, off-balance sheet obligations, the availability of assets readily converted to cash without undue loss, the amount of cash and liquid securities we hold, and the re-pricing characteristics and maturities of our assets when compared to the re-pricing characteristics of our liabilities and other factors.

The Company's liquid assets consist of cash and cash equivalents, which include investments in very short-term investments (i.e., federal funds sold), and investment securities classified as available for sale. The level of these assets is dependent on the Company's operating, investing, and financing activities during any given period. At December 31, 2012, cash and cash equivalents totaled \$45.3 million or 6.8% of total assets while investment securities classified as available for sale totaled \$194.5 million or 29.0% of total assets. Management believes that the liquidity needs of the Company are satisfied by the current balance of cash and cash equivalents, readily available access to traditional funding sources, FHLB advances, junior subordinated debt, and the portion of the investment and loan portfolios that mature within one year. These sources of funds will enable the Company to meet cash obligations and off-balance sheet commitments as they come due.

Operating activities provided net cash of \$10.3 million, \$9.1 million, and \$5.7 million for 2012, 2011, and 2010, respectively, generated principally from net income of \$6.3 million, \$4.1 million, and \$2.5 million in each of these respective periods.

Investing activities used \$8.0 million which consisted primarily of investment activity and loan originations. The cash usages primarily consisted of investment purchases of \$83.4 million and loan increases of \$8.7 million. Partially offsetting the usage are proceeds from repayments and maturities and proceeds from sale of securities of \$50.9 million and \$33.0 million, respectively. For the same period ended 2011, investing activities used \$19.4 million. These cash usages primarily consisted of loan increases of \$33.0 million, as well as investment purchases of \$80.1 million. Partially offsetting the usage of investment activities is \$69.3 million of proceeds from investment security maturities and repayments. During the same period ended 2010, investing activities used \$87.6 million in funds, principally for the net origination of loans and the purchase of investment securities of \$23.0 million and \$113.9 million, respectively.

Financing activities consist of the solicitation and repayment of customer deposits, borrowings and repayments, treasury stock activity, and the payment of dividends. During 2012, net cash provided by financing activities totaled \$8.7 million, principally derived from an increase in deposit accounts of \$12.4 million and offset by \$3.9 million to repay FHLB borrowings. During 2011, net cash provided by financing activities totaled \$14.0 million, principally derived from an increase in deposit accounts of \$15.7 million and offset by \$2.5 million to repay FHLB borrowings. During the same period ended 2010, net cash provided by financing activities totaled \$71.3 million, principally derived from an increase in deposit accounts.

Liquidity may be adversely affected by many circumstances, including unexpected deposit outflows and increased draws on lines of credit. Management monitors projected liquidity needs and determines the desirable level based in part on the Company's commitment to make loans and management's assessment of the Company's ability to generate funds. The Company anticipates having sufficient liquidity to satisfy estimated short and long-term funding needs.

Capital Resources. The Company's primary source of capital is retained earnings. Historically, the Company has generated net retained income to support normal growth and expansion. Management has developed a capital planning policy to not only ensure regulatory compliance but capital adequacy for future expansion.

Market Price of and Dividends on the Registrant's Common Equity and Related Stockholder Matters

The Company had approximately 1,058 stockholders of record as of December 31, 2012. There is no established market for the Company's common stock. The stock is traded very infrequently. Bid prices are quoted from time to time in the "pink sheets" under the symbol "MBCN." The "pink sheets" is a quotation service for over-the-counter securities that is maintained by Pink OTC Markets Inc., a privately owned company. The following table shows the high and low bid prices of and cash dividends paid on the Company's common stock in 2012 and 2011, adjusted for stock splits and stock dividends. This information does not reflect retail mark-up, markdown or commissions, and does not necessarily represent actual transactions.

	<u>High Bid</u>		<u>Low Bid</u>		<u>Cash Dividends per share</u>
2012					
First Quarter	\$	21.25	\$	17.00	\$ 0.26
Second Quarter	\$	24.50	\$	21.25	\$ 0.26
Third Quarter	\$	25.00	\$	21.55	\$ 0.26
Fourth Quarter	\$	26.70	\$	22.25	\$ 0.26
2011					
First Quarter	\$	19.00	\$	16.61	\$ 0.26
Second Quarter	\$	19.00	\$	17.00	\$ 0.26
Third Quarter	\$	18.37	\$	16.50	\$ 0.26
Fourth Quarter	\$	17.95	\$	16.15	\$ 0.26

MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a significant deficiency (as defined in Public Company Accounting Oversight Board Auditing Standard No. 5), or a combination of significant deficiencies, that results in there being more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis by management or employees in the normal course by management or employees in the normal course of performing their assigned functions.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2012. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on this assessment, management believes that, as of December 31, 2012, the Company's internal control over financial reporting was effective.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

/s/ Thomas G. Caldwell

By: Thomas G. Caldwell
President and Chief Executive Officer
(Principal Executive Officer)

Date: March 13, 2013

/s/ Donald L. Stacy

By: Donald L. Stacy
Treasurer
(Principal Financial & Accounting Officer)

Date: March 13, 2013

Exhibit 21

Middlefield Banc Corp. Subsidiaries

- 1 The Middlefield Banking Company (“MBC”), an Ohio-chartered commercial bank that began operations in 1901. MBC engages in a general commercial banking business in northeastern Ohio. The principal executive office is located at 15985 East High Street, Middlefield, Ohio 44062-0035.
- 2 Emerald Bank (“EB”), an Ohio-chartered commercial bank headquartered in Dublin, Ohio. EB engages in a general commercial banking business in central Ohio. The principal executive office is located at 6215 Perimeter Drive, Dublin Ohio 43017.
- 3 On October 23, 2009 Middlefield received from the Federal Reserve Bank of Cleveland approval to establish an asset resolution subsidiary. Organized as an Ohio corporation under the name EMORECO, Inc. and wholly owned by Middlefield Banc Corp, the purpose of the asset resolution subsidiary is to maintain, manage, and ultimately dispose of nonperforming loans and real estate acquired by subsidiary banks as the result of borrower default on real estate-secured loans.

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the previously filed Registration Statement (No. 333-5432) on Form S-8 and (No. 333-96579) on Form S-3D of Middlefield Banc Corp. of our report dated March 13, 2012, relating to our audits of the consolidated financial statements included in and incorporated by reference in the Annual Report on Form 10-K of Middlefield Banc Corp. for the year ended December 31, 2012.

/s/S.R. Snodgrass, A.C.

Wexford, PA
March 13, 2013



Certification of Principal Executive Officer

I, Thomas G. Caldwell, certify that:

1. I have reviewed this Form 10-K for the year ended December 31, 2012 of Middlefield Banc Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 13, 2013

/s/ Thomas G. Caldwell

Thomas G. Caldwell.
President and Chief Executive Officer



Certification of Principal Financial and Accounting Officer

I, Donald L. Stacy, certify that:

1. I have reviewed this Form 10-K for the year ended December 31, 2012 of Middlefield Banc Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 13, 2013

/s/ Donald L. Stacy

Donald L. Stacy
Principal Financial and Accounting Officer



Exhibit 32

***CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002***

In connection with the Annual Report of Middlefield Banc Corp. (the "Company") on Form 10-K for the period ending December 31, 2012 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, Thomas G. Caldwell, President, and Donald L. Stacy, Chief Financial Officer, certify, pursuant to 18 U.S.C., Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Thomas G. Caldwell

/s/ Donald L. Stacy

Thomas G. Caldwell
President and Chief Executive Officer

Donald L. Stacy
Principal Financial and Accounting Officer

Date: March 13, 2013

A signed original of this written statement required by Section 906 has been provided to Middlefield Banc Corp. and will be retained by Middlefield Banc Corp. and furnished to the Securities and Exchange Commission or its staff upon request

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Shareholder INFORMATION

CORPORATE HEADQUARTERS

Middlefield Banc Corp.
15985 East High Street
P.O. Box 35
Middlefield, Ohio 44062
888.801.1666 • 440.632.1666
fax: 440.632.1700

FORM 10-K AND 10-Q AVAILABILITY

A copy of Middlefield Banc Corp.'s Annual Report on Form 10-K and Quarterly Reports on 10-Q filed with the Securities and Exchange Commission will be furnished to any shareholder, free of charge, upon written or e-mail request to:

Donald L. Stacy

Treasurer and CFO
Middlefield Banc Corp.
P.O. Box 35
Middlefield, Ohio 44062
or dstacy@middlefieldbank.com

MARKET MAKERS

The symbol for Middlefield Banc Corp. common stock is MBCN and the CUSIP is 596304204.

Sweney Cartwright & Co.

17 South High Street, Suite 300
Columbus, Ohio 43215
614.228.5391 • 800.334.7481
www.swencart.com

Boenning & Scattergood, Inc.

9916 Brewster Lane
Powell, Ohio 43065
866.326.8113
www.boenninginc.com

Monroe Securities, Inc.

100 North Riverside Plaza, Suite 1620
Chicago, Illinois 60606
312.327.2530
www.monroesecurities.com

NOTICE OF ANNUAL MEETING

The Annual Meeting of Shareholders of Middlefield Banc Corp. will be held at 1:00 p.m. on Wednesday, May 15, 2013, at:

Sun Valley Banquet and Party Center
10000 Edwards Lane
Aurora, Ohio 44202

TRANSFER AGENT AND REGISTRAR

American Stock Transfer & Trust Company

59 Maiden Lane
Plaza Level
New York, New York 10038
800.937.5449

INDEPENDENT AUDITORS

S.R. Snodgrass, A.C.

2100 Corporate Drive, Suite 400
Wexford, Pennsylvania 15090-7647
724.934.0344

INTERNET INFORMATION

Information on the Company and its subsidiary banks is available on the Internet at www.middlefieldbank.com and www.emeraldbank.com.

DIVIDEND PAYMENT DATES

Subject to action by the Board of Directors, Middlefield Banc Corp. will pay dividends in March, June, September, and December.

DIVIDEND REINVESTMENT AND STOCK PURCHASE PLAN

Shareholders may elect to reinvest their dividends in additional shares of Middlefield Banc Corp.'s common stock through the Company's Dividend Reinvestment Plan. To arrange automatic purchase of shares with quarterly dividend proceeds, please call 888.801.1666.

DIRECT DEPOSIT OF DIVIDENDS

The direct deposit program, which is offered at no charge, provides for automatic deposit of quarterly dividends directly to a checking or savings account with The Middlefield Banking Company or Emerald Bank. For information regarding this program, please call 888.801.1666.

MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Middlefield Banc Corp. had approximately 1,061 shareholders of record as of February 27, 2013. There is no established public trading market for the Company's common shares. MBCN's common shares are traded on a limited basis. The following table shows the high and low bid prices of and cash dividends paid on the Company's common stock during the periods indicated. The high and low bid prices are compiled from data available through Yahoo Finance, Historical Prices. This information does not reflect retail mark-up, markdowns or commissions, and does not necessarily represent actual transactions.

	High Bid	Low Bid	Cash Dividends per share
2012			
First Quarter	\$21.25	\$17.00	\$0.26
Second Quarter	\$24.50	\$21.25	\$0.26
Third Quarter	\$25.00	\$21.55	\$0.26
Fourth Quarter	\$26.70	\$22.25	\$0.26
2011			
First Quarter	\$19.00	\$16.61	\$0.26
Second Quarter	\$19.00	\$17.00	\$0.26
Third Quarter	\$18.37	\$16.50	\$0.26
Fourth Quarter	\$17.95	\$16.15	\$0.26



MIDDLEFIELD BANC CORP.

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