MIDDLEFIELD BANC CORP
Form 10-K
March 13, 2013

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	34-1585111
(State or other jurisdiction of incorporation or organization)	(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 þ

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 þ

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 þ 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 þ 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 þ

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

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.

1

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 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	$400,654		$395,061		$366,277		$348,660		$318,018	

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					
	Commercial and	Real Estate	Mortgage		Consumer	
(Dollars in thousands)	Industrial	Construction	Residential	Commercial	Installment	Total

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	$62,188	$ 22,522	$203,872	$115,734	$4,117	$408,433

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.

(Dollars in thousands)	Fixed Rate	Adjustable Rate	Total
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
	$ 60,278	$ 348,155	$ 408,433

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,									
	2012		2011		2010		2009		2008	
(Dollars in thousands)	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	$ 29,882	7.31 %	$ 29,787	7.41 %	$ 31,270	8.39 %	$ 23,527	6.65 %	$ 10,904	3.39 %

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.

8

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

	Investment Portfolio Amortized Cost and Fair Value at December 31,					
	2012		2011		2010	
(Dollars in thousands)	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	$ 186,305	$ 194,472	$ 187,097	$ 193,977	$ 201,036	$ 201,772

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
	98	3.96	-	-	596	5.37	68,544	2.48	69,238	2.50	71,102

Mortgage-backed securities in government-sponsored entities											
Private-label mortgage-backed securities	-	-	591	5.57	-	-	3,962	4.93	4,553	5.01	5,064
Total	$2,179	6.19%	$5,555	5.67%	$22,310	3.86%	$155,511	3.89%	$185,555	3.97%	$193,722

** 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	$	79,918	100.00	%

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' 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:

	FDIC Regulations								
Capital Ratio	Adequately Capitalized		Well Capitalized			December 31, 2012		December 31, 2011	
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	

14

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 black-out 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 depositary 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’ 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:

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

Westerville Branch (Emerald Bank)	Franklin	Owned	
17 North State Street			
Westerville, OH			
Administrative Offices:	Geauga	Leased	five-year lease dated March 2012
15200 Madison Road Suite 108			
Middlefield, Ohio 44062			

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:

(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	Incorporated by reference to Exhibit 10.3 of Middlefield Banc Corp.'s Form 8-K Current

	January 7, 2008	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.

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

37