

ATOSSA GENETICS INC
Form DEF 14A
April 11, 2014

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

SCHEDULE 14A

**PROXY STATEMENT PURSUANT TO SECTION 14(a)
OF THE
SECURITIES EXCHANGE ACT OF 1934**

Filed by the Registrant
Filed by a Party other than the Registrant
Check the appropriate box:

- Preliminary Proxy Statement
- Definitive Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- Definitive Additional Materials
- Soliciting Material Pursuant to sec. 240.14a-11(c) or sec. 240.14a-12

ATOSSA GENETICS INC.

(Name of Registrant as Specified In Its Charter)

N/A

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- Fee not required.
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- (1) Title of each class of securities to which transaction applies.

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(1) Amount Previously Paid.

(2) Form, Schedule or Registration State No.:

(3) Filing Party:

(4) Date Filed:

TABLE OF CONTENTS

**1616 Eastlake Ave. East, Suite 510
Seattle, Washington 98102**

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
To Be Held on May 5, 2014**

Dear Stockholder:

You are cordially invited to attend the Annual Meeting of Stockholders of Atossa Genetics Inc., a Delaware corporation (the *Company*), which will be held on May 5, 2014, at 1:00 p.m. local time, at 1616 Eastlake Ave., East, First Floor Conference Room, Seattle, Washington 98102. Only stockholders who held stock at the close of business on the record date, April 4, 2014 (the *Record Date*), may vote at the Annual Meeting, including any adjournment or postponement thereof.

At the Annual Meeting, you will be asked to consider and vote upon: (1) the election of two Class II directors; (2) the ratification of the selection of KCCW Accountancy Corp. (*KCCW*) as our independent registered public accounting firm for the fiscal year ending December 31, 2014, and (3) the transaction of any other business that may properly come before the meeting or any adjournment thereof. No other items of business are expected to be considered at the meeting and no other director nominees will be entertained, pursuant to the Company's Bylaws. The enclosed Proxy Statement more fully describes the details of the business to be conducted at the Annual Meeting. After careful consideration, our Board of Directors has unanimously approved the proposals and recommends that you vote FOR each nominee and FOR the ratification of the selection of KCCW as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2014. After reading the Proxy Statement, please mark, date, and sign and return the enclosed proxy card in the accompanying reply envelope to ensure receipt by our tabulator. **YOUR SHARES CANNOT BE VOTED UNLESS YOU SIGN, DATE AND RETURN THE ENCLOSED PROXY OR ATTEND THE ANNUAL MEETING IN PERSON.**

A copy of the Atossa Genetics Inc. 2013 Annual Report has been mailed with this Proxy Statement to all stockholders entitled to notice of and to vote at the Annual Meeting.

We look forward to seeing you at the Annual Meeting.

Sincerely,

Steven C. Quay, M.D., Ph.D.
Chairman of the Board, President and
Chief Executive Officer

April 10, 2014

WHETHER OR NOT YOU EXPECT TO ATTEND THE MEETING, PLEASE MARK, DATE AND SIGN THE ENCLOSED PROXY AND RETURN IT AT YOUR EARLIEST CONVENIENCE IN THE ENCLOSED

POSTAGE-PREPAID RETURN ENVELOPE. EVEN IF YOU HAVE VOTED BY PROXY, YOU MAY STILL VOTE IN PERSON IF YOU ATTEND THE MEETING. PLEASE NOTE, HOWEVER, THAT IF YOUR SHARES ARE HELD OF RECORD BY A BROKER, BANK OR OTHER NOMINEE AND YOU WISH TO VOTE AT THE MEETING, YOU MUST OBTAIN A PROXY CARD ISSUED IN YOUR NAME FROM THAT INTERMEDIARY.

TABLE OF CONTENTS

**1616 Eastlake Ave. East, Suite 510
Seattle, Washington 98102**

**PROXY STATEMENT FOR
2014 ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD ON MAY 5, 2014**

GENERAL INFORMATION

This Proxy Statement is furnished in connection with the solicitation of proxies by the Board of Directors (the *Board*) of Atossa Genetics Inc. (*Atossa* or the *Company*) for use at the Company's 2014 annual meeting of stockholders, to be held at 1616 Eastlake Ave., East, First Floor Conference Room, Seattle, Washington 98102, on May 5, 2014, at 1:00 p.m. local time. This Proxy Statement and the accompanying form of proxy will be mailed to our stockholders on or about April 11, 2014. Unless otherwise indicated herein, this Proxy Statement speaks as of the close of business on April 4, 2014, which is the record date for the annual meeting (the *Record Date*).

For a proxy to be effective, it must be properly executed and received prior to the annual meeting. Each proxy properly tendered will, unless otherwise directed by the stockholder, be voted for the proposals and nominees described in this Proxy Statement and at the discretion of the proxy holder(s) with regard to all other matters that may properly come before the meeting.

The Company will pay all of the costs of soliciting proxies. We will provide copies of this Proxy Statement, notice of annual meeting and accompanying materials to brokerage firms, fiduciaries and custodians for forwarding to beneficial owners and will reimburse these persons for their costs of forwarding these materials. Our directors, officers and employees may also solicit proxies by telephone, facsimile, or personal solicitation; however, we will not pay them additional compensation for any of these services.

Only holders of record of our common stock (*common stock*) at the close of business on the Record Date are entitled to notice of and to vote at the annual meeting. On the Record Date, 24,428,568 shares of common stock were issued and outstanding. Each share of common stock is entitled to one vote on all matters to be voted upon at the annual meeting. Holders of common stock do not have the right to cumulative voting in the election of directors. The presence, in person or by proxy, of the holders of a majority of the outstanding shares on the Record Date will constitute a quorum for the transaction of business at the annual meeting and any adjournment thereof.

Persons who hold shares of Atossa common stock directly on the Record Date and not through a broker, bank or other financial institution (*record holders*) must return a proxy card or attend the annual meeting in person in order to vote on the proposals. Persons who hold shares of Atossa indirectly on the Record Date through a brokerage firm, bank or other financial institution (*beneficial holders*) must return a voting instruction form to have their shares voted on their behalf. Brokerage firms, banks or other financial institutions that do not receive voting instructions from beneficial holders may either vote these shares on behalf of the beneficial holders or return a proxy leaving these shares un-voted (a *broker non-vote*).

Abstentions and broker non-votes will be counted for the purpose of determining the presence or absence of a quorum, but will not be counted for the purpose of determining the number of votes cast on a given proposal. The required vote for each of the proposals expected to be acted upon at the annual meeting is described below:

Proposal No. 1 Election of directors. Directors are elected by a plurality, with the nominees obtaining the most votes being elected. Because there is no minimum vote required, abstentions and broker non-votes will be entirely excluded from the vote and will have no effect on its outcome.

1

TABLE OF CONTENTS

Proposal No. 2 Ratification of selection of independent registered public accounting firm. This proposal must be approved by a majority of the shares present in person or represented by proxy and entitled to vote on the proposal. As a result, abstentions will have the same effect as voting against the proposal and broker non-votes will have no effect on the vote outcome.

We encourage you to vote by returning your proxy or voting instruction form. By voting in advance of the meeting, this ensures that your shares will be voted and reduces the likelihood that the Company will be forced to incur additional expenses soliciting proxies for the annual meeting. Any record holder of our common stock may attend the annual meeting in person and may revoke the enclosed form of proxy at any time by:

executing and delivering to the corporate secretary a later-dated proxy;
delivering a written revocation to the corporate secretary before the meeting; or
voting in person at the annual meeting.

Beneficial holders of our common stock who wish to change or revoke their voting instructions should contact their brokerage firm, bank or other financial institution for information on how to do so. Beneficial holders who wish to attend the annual meeting and vote in person should contact their brokerage firm, bank or other financial institution holding shares of Atossa on their behalf in order to obtain a legal proxy, which will allow them to both attend the meeting and vote in person. Without a legal proxy, beneficial holders cannot vote at the annual meeting because their brokerage firm, bank or other financial institution may have already voted or returned a broker non-vote on their behalf.

TABLE OF CONTENTS

PROPOSAL NO. 1

ELECTION OF DIRECTORS

The Certificate of Incorporation of the Company provides that the Board is to be divided into three classes as nearly equal in number as reasonably possible, with directors in each class serving three-year terms. The total Board size is currently fixed at six directors. Currently, the Class I directors (whose terms expire at the 2016 annual meeting of stockholders) are Steven C. Quay, M.D., Ph.D., and Gregory L. Weaver. The Class II directors (whose terms expire at the 2014 annual meeting of stockholders) are Stephen J. Galli, M.D., and Richard I. Steinhart. The Class III directors (whose terms expire at the 2015 annual meeting of stockholders) are Shu-Chih Chen, Ph.D., and H. Lawrence Remmel, Esq. Class II directors elected at the annual meeting will hold office until the 2017 annual meeting of stockholders and until their successors are elected and qualified, unless they resign or their seats become vacant due to death, removal, or other cause in accordance with the Bylaws of the Company.

As described below, the Board has nominated Stephen J. Galli, M.D., and Richard I. Steinhart for reelection as Class II directors at the Annual Meeting. Both nominees have indicated their willingness to serve if elected. Should either of the nominees become unavailable for election at the annual meeting, the persons named on the enclosed proxy as proxy holders may vote all proxies given in response to this solicitation for the election of a substitute nominee chosen by the Board.

Nomination of Directors

The Nominating and Governance Committee, which acts as the Company's nominating committee, reviews and recommends to the Board potential nominees for election to the Board. In reviewing potential nominees, the Nominating and Governance Committee considers the qualifications of each potential nominee in light of the Board's existing and desired mix of experience and expertise. Specifically, the Nominating and Governance Committee considers each potential nominee's personal and professional ethics, integrity and values, business acumen, interest in the Company and commitment to representing the long-term interests of the stockholders. The Nominating and Governance Committee also seeks to have a Board that encompasses a range of talents, ages, skills, diversity, and expertise sufficient to provide sound and prudent oversight with respect to the operations and interests of the business. These criteria are set forth in our Corporate Governance Guidelines, a copy of which is available on our website at www.atossagenetics.com.

After reviewing the qualifications of potential Board candidates, the Nominating and Governance Committee presents its recommendations to the Board, which selects the final director nominees. Upon the recommendation of the Nominating and Governance Committee, the Board nominated Dr. Galli and Mr. Steinhart for reelection as Class II directors. The Company did not pay any fees to any third parties to identify or assist in identifying or evaluating nominees for the annual meeting.

The Nominating and Governance Committee considers stockholder nominees using the same criteria set forth above. Stockholders who wish to present a potential nominee to the Nominating and Governance Committee for consideration for election at a future annual meeting of stockholders must provide the Nominating and Governance Committee with notice of the nomination and certain information regarding the candidate within the time periods set forth below under the caption "Stockholder Proposals."

Although the Nominating and Governance Committee may consider whether nominees assist in achieving a mix of Board members that represents a diversity of background and experience, which is not only limited to race, gender or national origin, we have no formal policy regarding board diversity.

3

TABLE OF CONTENTS**Nominees and Incumbent Directors**

The Nominating and Governance Committee has recommended, and the Board has nominated, Mr. Steinhart and Dr. Galli to be reelected Class II directors at the annual meeting. The following table sets forth the following information for these nominees and the Company's continuing directors: the year each was first elected a director of the Company; their respective ages as of the date of filing of this proxy statement; the positions currently held with the Company; the year their current term will expire and their current class.

Nominee/Director Name and Year First Became a Director	Age	Position(s) with the Company	Year Current Term Expires	Current Director Class
Nominees for Class II Directors:				
Stephen J. Galli, M.D. (2011)	67	Director	2014	II
Richard I. Steinhart (2014)	56	Director	2014	II
Continuing Directors:				
Steven C. Quay, M.D., Ph.D. (2009)	63	Chairman of the Board of Directors, President and Chief Executive Officer	2016	I
Gregory L. Weaver (2013)	57	Director	2016	I
Shu-Chih Chen, Ph.D. (2009)	52	Director and Chief Scientific Officer	2015	III
H. Lawrence Rimmel, Esq. (2012)	62	Director	2015	III

Class II Directors Nominated for Election

The following persons have been nominated by the Board to be elected as Class II directors at the 2014 annual meeting.

Stephen J. Galli, M.D. Dr. Galli has served as a director of the Company since July 2011. Dr. Galli is Chair of the Department of Pathology, Professor of Pathology and of Microbiology & Immunology and the Mary Hewitt Loveless, M.D., Professor, Stanford University School of Medicine, Stanford, California, and has served in these capacities since February 1999. Before joining Stanford, he was on the faculty of Harvard Medical School. He holds 13 U.S. patents and has over 340 publications. He is past president of the American Society for Investigative Pathology and current president of the Collegium Internationale Allergologicum. In addition to receiving awards for his research, he was recently recognized with the 2010 Stanford University President's Award for Excellence through Diversity for his recruitment and support of women and underrepresented minorities at Stanford University. He received his B.A. degree in biology, magna cum laude, from Harvard College in 1968 and his M.D. degree from Harvard Medical School in 1973 and completed a residency in anatomic pathology at the Massachusetts General Hospital in 1977. Dr. Galli has been selected to serve on the Company's Board of Directors because of his qualifications as a professor and physician, and his specialized expertise as a pathologist.

Richard I. Steinhart. Mr. Steinhart has served as a director of the Company since March 2014. From April 2006 to December 2013, Mr. Steinhart was an executive at MELA Sciences, Inc., most recently serving as its Chief Financial Officer, Senior Vice President, Treasurer and Secretary. From 1992 to 2006, Mr. Steinhart was Managing Director at Forest St. Capital/SAE Ventures. Earlier, he served as Vice President and Chief Financial Officer at Emisphere Technologies from 1991 to 1992 and as General Partner and Chief Financial Officer of CW Group Inc. Mr. Steinhart is a Member of the Board of Directors of Actinium Pharmaceuticals where he is Chairman of the Audit Committee

and a member of the Compensation Committee. From 2004 to 2012, Mr. Steinhart was a Member of the Board of Directors of Manhattan Pharmaceuticals and was Chairman of the Audit Committee. Mr. Steinhart received his B.B.A. and M.B.A. degrees from Pace University. Mr. Steinhart has been selected to serve on the Company's Board of Directors because of his qualifications as a business executive and audit committee financial expert, and his prior experience as a Chief Financial Officer, director and committee member of public companies.

4

TABLE OF CONTENTS

Class I Directors continuing in office until 2016

Steven C. Quay, M.D., Ph.D. Dr. Quay has served as Chief Executive Officer, President and Chairman of the Board of Directors of the Company since the Company was incorporated in April 2009. Prior to his work at the Company, Dr. Quay served as Chairman of the Board, President and Chief Executive Officer of MDRNA, Inc., a biotechnology company focused on the development and commercialization of RNAi-based therapeutic products, from August 2000 to May 2008, and as its Chief Scientific Officer until November 30, 2008 (MDRNA, Inc. was formerly known as Natestch Pharmaceutical Company Inc. and is currently known as Marina Biotech, Inc.). From December 2008 to April 2009, Dr. Quay was involved in acquiring the Company's assets and preparing the Company's business plan. Dr. Quay is certified in Anatomic Pathology with the American Board of Pathology, completed both an internship and residency in anatomic pathology at Massachusetts General Hospital, a Harvard Medical School teaching hospital, is a former faculty member of the Department of Pathology, Stanford University School of Medicine, and is a named inventor on 14 U.S. and foreign patents covering the ForeCYTE Breast Aspirator. Including the patents for the ForeCYTE Breast Aspirator, Dr. Quay is a named inventor on 76 U.S. patents, 108 pending patent applications and is a named inventor on patents covering five pharmaceutical products that have been approved by the U.S. Food and Drug Administration. Dr. Quay received an M.D. in 1977 and a Ph.D. in 1975 from the University of Michigan Medical School. He also received his B.A. degree in biology, chemistry and mathematics from Western Michigan University in 1971. Dr. Quay is a member of the American Society of Investigative Pathology, the Association of Molecular Pathology, the Society for Laboratory Automation and Screening and the Association of Pathology Informatics. He was selected to serve on the Company's Board of Directors because of his role as a founder of the Company and the inventor of the ForeCYTE Breast Aspirator, as well as his qualifications as a physician and the principal researcher overseeing the clinical and regulatory development of the ForeCYTE Breast Aspirator.

Gregory L. Weaver. Mr. Weaver has served as a director of the Company since October 2013. Mr. Weaver currently serves as Chief Financial Officer, Senior Vice President, Treasurer and Corporate Secretary of Fibrocell Science, Inc., an autologous cellular therapeutic company. From June 2011 to July 2013, Mr. Weaver served as Chief Financial Officer and Senior Vice President of Celsion Corp., an oncology drug development company. From February 2009 to October 2010, Mr. Weaver served as Chief Financial Officer and Senior Vice President of Poniard Pharmaceuticals, Inc., a drug development company. From April 2007 to December 2008, Mr. Weaver served as Chief Financial Officer of Talyst, Inc., an information technology services company. Mr. Weaver received his B.S. degree from Trinity University and his M.B.A. degree from Boston College. Mr. Weaver has been selected to serve on the Company's Board of Directors because of his qualifications as a business executive and audit committee financial expert, and his current and prior experience as a Chief Financial Officer, director and committee member of public companies.

Class III Directors continuing in office until 2015

Shu-Chih Chen, Ph.D. Dr. Chen has served as Chief Scientific Officer and director of the Company since the Company was incorporated in April 2009. Prior to joining the Company, Dr. Chen served as President of Ensisheim beginning in 2008, was founder and President of SC2Q Consulting Company from 2006 to 2008, and served as Head, Cell Biology, Natestch Pharmaceuticals Company, Inc. from 2002 to 2006. During 1995 and 1996, she was an Associate Professor at National Yang Ming University, Taipei, Taiwan, and served as the principal investigator of an NIH RO1 grant studying tumor suppression by gap junction protein connexin 43 at the Department of Molecular Medicine at Northwest Hospital before working in the research department at Natestch Pharmaceutical Company. She is named as an inventor on four patent applications related to cancer therapeutics. Dr. Chen received her Ph.D. degree in microbiology and public health from Michigan State University in 1992 and has published extensively on Molecular Oncology. She received her B.S. degree in medical technology from National Yang Ming University,

Taipei, Taiwan in 1984. Dr. Chen was selected to serve on the Company's Board of Directors because of her role as a founder of the Company and her qualifications in medical technology and as a professor and researcher in the field of cancer therapeutics.

H. Lawrence Rimmel, Esq. Mr. Rimmel has served as a director of the Company since February 2012. He is currently a partner of the law firm Pryor Cashman LLP, located in New York City, where he chairs the Banking and Finance practice group. Mr. Rimmel joined Pryor Cashman in 1988. His practice includes corporate and banking financings, issues relating to the Investment Company Act of 1940, and intellectual

TABLE OF CONTENTS

property and licensing issues, in particular in the biotechnology and biocosmeceutical areas. Mr. Remmel serves on the Board of Advisors of CytoDel, LLC, an early stage bio-pharmaceutical company developing products for bio defense, neurol drug delivery and aesthetic medicine. He was an associate of the law firm Reboul, MacMurray, Hewitt, Maynard & Kristol from 1984 to 1988, and began his legal career at Carter, Ledyard & Milburn, where he was an associate from 1979 to 1984. He was admitted to the New York bar in 1980 and is a member of the New York State Bar Association. He received his J.D. from the Washington & Lee University School of Law in 1979 and his B.A. from Princeton University in 1975. Mr. Remmel has been selected to serve on the Company's Board of Directors because of his substantial experience as a corporate attorney advising biotechnology companies and his familiarity with the fiduciary duties and the regulatory requirements affecting publicly traded companies.

Vote Required

The nominees who receive the greatest number of affirmative votes of the shares present in person or by proxy will be elected as Class II directors. Any shares that are not voted, whether by abstention, broker non-votes or otherwise, will not affect the election of directors.

Holders of proxies solicited by this Proxy Statement will vote the proxies received by them as directed on the proxy card or, if no direction is made, then FOR the election of all nominees named in this Proxy Statement.

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE
FOR
THE NOMINEES IDENTIFIED ABOVE.**

TABLE OF CONTENTS

PROPOSAL NO. 2

RATIFICATION OF SELECTION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Our Audit Committee has selected KCCW Accountancy Corp. (*KCCW*) as our independent registered public accounting firm for the fiscal year ending December 31, 2014, and has further directed that we submit the selection of KCCW for ratification by our stockholders at the annual meeting.

The Company is not required to submit the selection of our independent registered public accounting firm for stockholder approval. However, if the stockholders do not ratify this selection, the Audit Committee will reconsider its selection of KCCW. Even if the selection is ratified, our Audit Committee may direct the appointment of a different independent registered public accounting firm at any time during the year if the Audit Committee determines that the change would be in the best interests of the Company.

The Audit Committee reviews and pre-approves all audit and non-audit services performed by its independent registered public accounting firm, as well as the fees charged for such services. All fees incurred in fiscal 2013 for services rendered by KCCW were approved in accordance with these policies. In its review of non-audit service fees, the Audit Committee considers, among other things, the possible impact of the performance of such services on the auditor's independence. The Audit Committee has determined that the non-audit services performed by KCCW in the fiscal year ended December 31, 2013 were compatible with maintaining the auditor's independence. Additional information concerning the Audit Committee and its activities can be found in the following sections of this Proxy Statement: Board Committees and Report of the Audit Committee.

KCCW has reviewed our interim financial statements since the quarter ended March 31, 2010 and has audited our annual financial statements since the year ended December 31, 2009. Representatives of KCCW are expected to be present at the annual meeting in person or by telephone, will have the opportunity to make a statement if they desire to do so and will be available to respond to appropriate stockholder questions.

Fees for Independent Registered Public Accounting Firm

The following is a summary of the fees billed to the Company by KCCW for professional services rendered for the fiscal years ended December 31, 2013 and 2012. These fees are for work invoiced in the fiscal years indicated.

	2013	2012
Audit Fees:		
Consists of fees billed for audit of our annual financial statements and the review of the financial statements included in our quarterly reports on Form 10-Q, and services that are normally provided by KCCW in connection with statutory and regulatory filings or engagements for that fiscal year.	\$ 71,000	\$ 57,000
Other Fees:		
Audit-Related Fees		

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Consists of fees billed for services rendered in connection with our Forms S-1, Form S-3 and Form S-8, accounting research and services on transaction and proposed transaction related matters, and out-of-pocket expenses related to the audit.	37,129	55,586
Tax Fees		
All Other Fees		
Total Other Fees	37,129	55,586
Total All Fees	\$ 108,129	\$ 112,586

7

TABLE OF CONTENTS

Vote Required

Ratification of the selection of the independent registered public accounting firm requires the affirmative vote of a majority of the shares present in person or represented by proxy and entitled to vote on the proposal. Abstentions will have the same effect as voting against the proposal. Because broker non-votes are not counted as votes for or against this proposal, they will have no effect on the outcome of the vote.

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE
FOR PROPOSAL NO. 2.**

8

TABLE OF CONTENTS

CORPORATE GOVERNANCE

Director Independence

We believe that the Company benefits from having a strong and independent Board. For a director to be considered independent, the Board must determine that the director does not have any direct or indirect material relationship with the Company that would affect his or her exercise of independent judgment. On an annual basis, the Board reviews the independence of all directors under guidelines established by NASDAQ and in light of each director's affiliations with the Company and members of management, as well as significant holdings of Company securities. This review considers all known relevant facts and circumstances in making an independence determination. Based on this review, the Board has made an affirmative determination that all directors, other than Drs. Quay and Chen, are independent. It was determined that Dr. Quay lacks independence because of his status as the Company's President and Chief Executive Officer and that Dr. Chen lacks independence because of her status as the Company's Chief Scientific Officer.

Corporate Code of Business Conduct and Ethics

We believe that our Board and committees, led by a group of strong and independent directors, provide the necessary leadership, wisdom and experience that the Company needs in making sound business decisions. Our Corporate Code of Business Conduct and Ethics helps clarify the operating standards and ethics that we expect of all of our officers, directors and employees in making and implementing those decisions. Waivers of our Corporate Code of Business Conduct and Ethics may only be granted by the Board or the Audit Committee and will be publicly announced promptly on our website. In furthering our commitment to these principles, we invite you to review our Corporate Code of Business Conduct and Ethics located on our website at www.atossagenetics.com.

Stockholder Communications

Generally, stockholders who have questions or concerns regarding the Company should contact our Investor Relations representative at (800) 351-3902. However, any stockholders who wish to address questions regarding the business or affairs of the Company directly with the Board, or any individual director, should direct his or her questions in writing to the Chairman of the Board, Atossa Genetics Inc., 1616 Eastlake Ave. East, Suite 510, Seattle, Washington 98102. Upon receipt of any such communications, the correspondence will be directed to the appropriate person, including individual directors.

BOARD OF DIRECTORS AND COMMITTEES

During fiscal 2013, our Board met 10 times. Each director attended at least 75% of the aggregate of the meetings of the Board and meetings of the committees of which he or she was a member in our last fiscal year. During fiscal 2013, our Board had an Audit Committee, a Compensation Committee and a Nominating and Governance Committee. All members of the Audit, Compensation and Nominating and Governance Committees are non-employee directors who are deemed independent.

Although the Company has no formal policies regarding director attendance at annual meetings, it does expect that all members of the Board will attend the 2014 Annual Meeting. All members of the Board were present in person at the

2013 annual meeting.

Board Leadership Structure and Risk Oversight

The Board currently combines the role of Chairman of the Board with the role of Chief Executive Officer. The Board believes this leadership model, together with four of the other five Board members being independent, all key committees of the Board being comprised solely of, and chaired by, independent directors, and the Company's established governance guidelines, provides an effective leadership structure for the Company. Combining the Chairman and Chief Executive Officer roles fosters clear accountability, effective decision-making, and aligns corporate strategy with the Company's day-to-day operations. In addition, to ensure effective independent oversight of the Company, the Board holds meetings of the independent directors of the Board at every meeting.

9

TABLE OF CONTENTS

Dr. Quay has served as Chairman and Chief Executive Officer since the Company was incorporated in April 2009.

The independent directors believe that because Dr. Quay manages the Company on a day-to-day basis as Chief Executive Officer and President, his direct involvement in the Company's operations makes him uniquely qualified to lead the Board in effective decision-making and to efficiently align the Company's day-to-day operations with the Board's objectives.

The Board has overall responsibility for the oversight of the Company's risk management process, which is designed to support the achievement of organizational objectives, including strategic objectives, to improve long-term organizational performance and enhance shareholder value. Risk management includes not only understanding company-specific risks and the steps management implements to manage those risks, but also what level of risk is acceptable and appropriate for the Company. Management is responsible for establishing our business strategy, identifying and assessing the related risks and implementing appropriate risk management practices. The Board periodically reviews our business strategy and management's assessment of the related risk, and discusses with management the appropriate level of risk for the Company. The Board also delegates oversight to Board committees to oversee selected elements of risk as set forth below.

Board Committees

Audit Committee. As of the Record Date, the Audit Committee was comprised of Messrs. Weaver (Chairman), Steinhart and Rimmel. The Audit Committee selects the Company's independent registered public accounting firm, approves its compensation, oversees and evaluates the performance of the independent registered public accounting firm, oversees the accounting and financial reporting policies and internal control systems of the Company, reviews the Company's interim and annual financial statements, independent registered public accounting firm reports and management letters, and performs other duties, as specified in the Audit Committee Charter, a copy of which is available on the Company's website at www.atossagenetics.com. Additionally, the Audit Committee is involved in the oversight of the Company's risk management through its review of policies relating to risk assessment and management. The Audit Committee met five times in fiscal 2013. All members of the Audit Committee satisfy the current independence standards promulgated by NASDAQ and the SEC and the Board has determined that Greg Weaver qualifies as an audit committee financial expert, as the SEC has defined that term in Item 407 of Regulation S-K.

Compensation Committee. As of the Record Date, the Compensation Committee was comprised of Mr. Steinhart and Dr. Galli. The Compensation Committee reviews and recommends the compensation arrangements for management, or approves such arrangements if so directed by the Board, establishes and reviews general compensation policies, administers the Company's equity compensation plans and reviews and recommends to the Board the compensation paid to non-employee directors for their service on the Board. Our Chief Executive Officer makes recommendations to the Compensation Committee regarding the corporate and individual performance goals and objectives relevant to executive compensation and executives' performance in light of such goals and objectives, and recommends other executives' compensation levels to the Compensation Committee based on such evaluations. The Compensation Committee considers these recommendations and then makes an independent decision regarding officer compensation levels and awards. The Compensation Committee met five times in fiscal 2013. A copy of the Compensation Committee charter is available on the Company's website at www.atossagenetics.com. All members of the Compensation Committee satisfy the current NASDAQ independence standards.

Nominating and Governance Committee. As of the Record Date, the Nominating and Governance Committee was comprised of Dr. Galli (Chairman) and Mr. Rimmel. The Nominating and Governance Committee identifies and nominates candidates for election to the Board, establishes policies under which stockholders may recommend a

candidate for consideration for nomination as a director, annually reviews and evaluates the performance, operations, size and composition of the Board and periodically assesses and reviews the Company's Corporate Governance Guidelines and recommends any appropriate changes thereto. The Nominating and Governance Committee met three times in fiscal 2013. A copy of the Corporate Governance Committee charter is available on our website at www.atossagenetics.com. All members of the Corporate Governance Committee satisfy the current NASDAQ independence standards.

TABLE OF CONTENTS

	138	384	439		
Data processing expense	364	336	1,074	995	
Director compensation	58	74	177	221	
Professional fees	105	111	286	341	
Taxes, other than income	115	123	346	374	
FDIC Insurance premiums	82	73	242	291	
Loss (gain) on sales of other real estate owned	4	(14)	3	(28)	
Amortization of intangibles	12	12	34	34	
Other non-interest expense	363	368	1,109	1,106	

Total non-interest expense 3,273 3,109 9,738 9,572

Income before income taxes 1,486 1,627 3,501 4,718
 Provision for income taxes 354 413 736 1,174

Net income \$1,132 \$1,214 \$2,765 \$3,544

Earnings per share

Basic	\$0.27	\$0.29	\$0.65	\$0.84
Diluted	\$0.27	\$0.29	\$0.65	\$0.83
Cash dividends declared per share	\$0.22	\$0.22	\$0.66	\$0.64
Weighted average basic shares outstanding	4,235,207	4,236,168	4,231,718	4,243,273
Weighted average diluted shares outstanding	4,236,542	4,239,872	4,234,008	4,246,533

See accompanying notes to consolidated financial statements.

Table of Contents**Juniata Valley Financial Corp. and Subsidiary****Consolidated Statements of Comprehensive Income**

(Unaudited, in thousands)

	Three Months Ended September 30, 2012			Three Months Ended September 30, 2011		
	Before Tax Amount	Tax Expense or (Benefit)	Net-of-Tax Amount	Before Tax Amount	Tax Expense or (Benefit)	Net-of-Tax Amount
Net income	\$ 1,486	\$ 354	\$ 1,132	\$ 1,627	\$ 413	\$ 1,214
Other comprehensive income:						
Unrealized gains (losses) on available for sale securities:						
Unrealized gains arising during the period	134	45	89	147	50	97
Unrealized gains (losses) from unconsolidated subsidiary	(1)		(1)	1		1
Change in pension liability	74	25	49	40	14	26
Other comprehensive income	207	70	137	188	64	124
Total comprehensive income	\$ 1,693	\$ 424	\$ 1,269	\$ 1,815	\$ 477	\$ 1,338

	Nine Months Ended September 30, 2012			Nine Months Ended September 30, 2011		
	Before Tax Amount	Tax Expense or (Benefit)	Net-of-Tax Amount	Before Tax Amount	Tax Expense or (Benefit)	Net-of-Tax Amount
Net income	\$ 3,501	\$ 736	\$ 2,765	\$ 4,718	\$ 1,174	\$ 3,544
Other comprehensive income:						
Unrealized gains (losses) on available for sale securities:						
Unrealized gains arising during the period	273	92	181	556	189	367
Unrealized gains (losses) from unconsolidated subsidiary	(2)		(2)	6		6
Less reclassification adjustment for:						
gains included in net income	(2)	(1)	(1)	(6)	(2)	(4)
Change in pension liability	222	75	147	118	40	78
Other comprehensive income	491	166	325	674	227	447
Total comprehensive income	\$ 3,992	\$ 902	\$ 3,090	\$ 5,392	\$ 1,401	\$ 3,991

See accompanying notes to consolidated financial statements.

Table of Contents**Juniata Valley Financial Corp. and Subsidiary****Consolidated Statements of Changes in Stockholders' Equity**

(Unaudited)

(in thousands, except share data)

	Number of Shares Outstanding	Common Stock	Nine Months Ended September 30, 2012				Treasury Stock	Total Stockholders Equity
			Surplus	Retained Earnings	Accumulated Other Comprehensive Loss			
Balance at January 1, 2012	4,228,218	\$ 4,746	\$ 18,363	\$ 38,900	\$ (2,256)	\$ (10,033)	\$ 49,720	
Net income				2,765			2,765	
Other comprehensive income					325		325	
Cash dividends at \$0.66 per share				(2,793)			(2,793)	
Stock-based compensation			17				17	
Purchase of treasury stock	(4,664)					(85)	(85)	
Treasury stock issued for stock option and stock purchase plans	9,936		(40)			193	153	
Balance at September 30, 2012	4,233,490	\$ 4,746	\$ 18,340	\$ 38,872	\$ (1,931)	\$ (9,925)	\$ 50,102	

	Number of Shares Outstanding	Common Stock	Nine Months Ended September 30, 2011				Treasury Stock	Total Stockholders Equity
			Surplus	Retained Earnings	Accumulated Other Comprehensive Loss			
Balance at January 1, 2011	4,257,765	\$ 4,746	\$ 18,354	\$ 37,868	\$ (1,465)	\$ (9,527)	\$ 49,976	
Net income				3,544			3,544	
Other comprehensive income					447		447	
Cash dividends at \$0.64 per share				(2,716)			(2,716)	
Stock-based compensation			19				19	
Purchase of treasury stock	(24,500)					(417)	(417)	
Treasury stock issued for stock option and stock purchase plans	2,903		(10)			56	46	
Balance at September 30, 2011	4,236,168	\$ 4,746	\$ 18,363	\$ 38,696	\$ (1,018)	\$ (9,888)	\$ 50,899	

See accompanying notes to consolidated financial statements.

Table of Contents**Juniata Valley Financial Corp. and Subsidiary****Consolidated Statements of Cash Flows**

(Unaudited)

(in thousands)

	Nine Months Ended September 30,	
	2012	2011
Operating activities:		
Net income	\$ 2,765	\$ 3,544
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,237	264
Depreciation	396	447
Net amortization of securities premiums	298	271
Net amortization of loan origination costs	13	33
Deferred net loan origination fees (costs)	(53)	8
Amortization of core deposit intangible	34	34
Net realized gains on sales or calls of securities	(2)	(6)
Net losses (gains) on sales of other real estate owned	3	(28)
Earnings on bank owned life insurance and annuities	(345)	(366)
Deferred income tax expense (benefit)	(138)	45
Equity in earnings of unconsolidated subsidiary, net of dividends of \$35 and \$19	(145)	(178)
Stock-based compensation expense	17	19
Mortgage loans originated for sale	(7,845)	
Proceeds from loans sold to others	8,193	
Net gains on sales of loans	(420)	
Increase in accrued interest receivable and other assets	(1,163)	(538)
Increase (decrease) in accrued interest payable and other liabilities	(137)	118
Net cash provided by operating activities	2,708	3,667
Investing activities:		
Purchases of:		
Securities available for sale	(71,427)	(76,365)
Premises and equipment	(127)	(168)
Bank owned life insurance and annuities	(65)	(66)
Proceeds from:		
Maturities of and principal repayments on:		
Securities available for sale	57,948	44,218
Redemption of FHLB stock	313	298
Bank owned life insurance and annuities	11	20
Proceeds from life insurance claim	147	
Sale of other real estate owned	504	479
Sale of other assets	2	9
Investment in low income housing partnership	(1,910)	
Net decrease in interest bearing time deposits	249	249
Net decrease in loans receivable	9,633	5,276
Net cash used in investing activities	(4,722)	(26,050)
Financing activities:		
Net increase in deposits	6,644	18,321

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Net increase (decrease) in securities sold under agreements to repurchase	768	(257)
Cash dividends	(2,793)	(2,716)
Purchase of treasury stock	(85)	(417)
Treasury stock issued for employee stock plans	153	46
Net cash provided by financing activities	4,687	14,977
Net increase (decrease) in cash and cash equivalents	2,673	(7,406)
Cash and cash equivalents at beginning of year	14,174	25,276
Cash and cash equivalents at end of year	\$ 16,847	\$ 17,870
Supplemental information:		
Interest paid	\$ 2,767	\$ 3,512
Income taxes paid	825	1,075
Supplemental schedule of noncash investing and financing activities:		
Transfer of loans to other real estate owned	\$ 993	\$ 251
Transfer of loans to other assets		9

See accompanying notes to consolidated financial statements.

Table of Contents**Juniata Valley Financial Corp. and Subsidiary**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

NOTE 1 Basis of Presentation and Accounting Policies

The consolidated financial statements include the accounts of Juniata Valley Financial Corp. (the Company) and its wholly owned subsidiary, The Juniata Valley Bank (the Bank). All significant intercompany accounts and transactions have been eliminated.

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles (U.S. GAAP) for complete financial statements. In the opinion of management, all adjustments considered necessary for fair presentation have been included. For comparative purposes, whenever necessary, the 2011 balances have been reclassified to conform to the 2012 presentation. Such reclassifications, if any, had no impact on net income. Operating results for the three and nine month periods ended September 30, 2012, are not necessarily indicative of the results for the year ended December 31, 2012. For further information, refer to the consolidated financial statements and footnotes thereto included in Juniata Valley Financial Corp.'s Annual Report on Form 10-K for the year ended December 31, 2011.

The Company has evaluated events and transactions occurring subsequent to the statement of financial condition date of September 30, 2012 for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

NOTE 2 Recent Accounting Pronouncements

There were no new accounting pronouncements affecting the Company during the current quarter.

NOTE 3 Accumulated Other Comprehensive Loss

Components of accumulated other comprehensive loss, net of tax consisted of the following (in thousands):

	9/30/2012	12/31/2011
Unrealized gains on available for sale securities	\$ 1,001	\$ 823
Unrecognized expense for defined benefit pension	(2,932)	(3,079)
Accumulated other comprehensive loss	\$ (1,931)	\$ (2,256)

Table of Contents

NOTE 4 Earnings per Share

The following table sets forth the computation of basic and diluted earnings per share:

<i>(Amounts, except earnings per share, in thousands)</i>	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011
Net income	\$ 1,132	\$ 1,214
Weighted-average common shares outstanding	4,235	4,236
Basic earnings per share	\$ 0.27	\$ 0.29
Weighted-average common shares outstanding	4,235	4,236
Common stock equivalents due to effect of stock options	1	4
Total weighted-average common shares and equivalents	4,236	4,240
Diluted earnings per share	\$ 0.27	\$ 0.29
	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Net income	\$ 2,765	\$ 3,544
Weighted-average common shares outstanding	4,232	4,243
Basic earnings per share	\$ 0.65	\$ 0.84
Weighted-average common shares outstanding	4,232	4,243
Common stock equivalents due to effect of stock options	2	3
Total weighted-average common shares and equivalents	4,234	4,246
Diluted earnings per share	\$ 0.65	\$ 0.83

NOTE 5 Commitments, Contingent Liabilities and Guarantees

In the ordinary course of business, the Company makes commitments to extend credit to its customers through letters of credit, loan commitments and lines of credit. At September 30, 2012, the Company had \$41,551,000 outstanding in loan commitments and other unused lines of credit extended to its customers as compared to \$38,033,000 at December 31, 2011.

The Company does not issue any guarantees that would require liability recognition or disclosure, other than its letters of credit. Letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Generally, letters of credit have expiration dates within one year of issuance. The credit risk involved in issuing letters of credit is essentially the same as the risks that are involved in extending loan facilities to customers. The Company generally holds collateral and/or personal guarantees supporting these commitments. The Company had outstanding \$1,202,000 and \$1,067,000 of letters of credit commitments as of September 30, 2012 and December 31, 2011, respectively. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The current amount of the liability as of September 30, 2012 for payments under letters of credit issued was not material. Because these instruments have fixed maturity dates, and because many of them will expire without being drawn upon, they do not generally present any significant liquidity risk.

Table of Contents

NOTE 6 Defined Benefit Retirement Plan

The Company had a defined benefit retirement plan covering substantially all of its employees, prior to January 1, 2008. Effective January 1, 2008, the plan was amended to close the plan to new entrants. The benefits under the plan are based on years of service and the employees compensation. The Company's funding policy allows contributions annually up to the maximum amount that can be deducted for federal income taxes purposes. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. The Company has made no contributions in the first nine months of 2012 and does not expect to contribute to the defined benefit plan in the remainder of 2012. Pension expense included the following components for the three and nine month periods ended September 30, 2012 and 2011:

<i>(Dollars in thousands)</i>	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Components of net periodic pension cost				
Service cost	\$ 55	\$ 48	\$ 166	\$ 144
Interest cost	113	119	338	358
Expected return on plan assets	(148)	(158)	(443)	(474)
Amortization of net loss	74	38	222	114
Net periodic pension cost	\$ 94	\$ 47	\$ 283	\$ 142

On September 18, 2012, the Company's Board of Directors approved a plan to freeze future benefit accruals in the defined benefit plan effective on December 31, 2012.

NOTE 7 Acquisition

In 2006, the Company acquired a branch office in Richfield, PA. The acquisition included real estate, deposits and loans. The assets and liabilities of the acquired business were recorded on the consolidated statement of financial condition at their estimated fair values as of September 8, 2006, and their results of operations have been included in the consolidated statements of income since such date.

Included in the purchase price of the branch were goodwill and core deposit intangible of \$2,046,000 and \$449,000, respectively. The core deposit intangible is being amortized over a ten-year period on a straight line basis. For the three-month periods ending September 30, 2012 and September 30, 2011, amortization expense was \$12,000. During the first nine months of 2012 and 2011, amortization expense was \$34,000 in each period. Accumulated amortization of core deposit intangible through September 30, 2012 was \$273,000. The goodwill is not amortized, but is measured annually for impairment or more frequently if certain events occur which might indicate goodwill has been impaired. There was no impairment of goodwill during the nine month periods ended September 30, 2012 or 2011.

NOTE 8 Investment in Unconsolidated Subsidiary

The Company owns 39.16% of the outstanding common stock of Liverpool Community Bank (LCB), Liverpool, PA. This investment is accounted for under the equity method of accounting. The investment is being carried at \$3,939,000 as of September 30, 2012. The Company increases its investment in LCB for its share of earnings and decreases its investment by any dividends received from LCB. A loss in value of the investment which is other than a temporary decline would be recognized in earnings. Evidence of a loss in value that is other than temporary might include, but would not necessarily be limited to, absence of an ability to recover the carrying amount of the investment or inability of LCB to sustain an earnings capacity which would justify the carrying amount of the investment.

Table of Contents

NOTE 9 Securities

ASC Topic 320, *Investments – Debt and Equity Securities*, clarifies the interaction of the factors that should be considered when determining whether a debt security is other-than-temporarily impaired. For debt securities, management must assess whether (a) it has the intent to sell the security and (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery. These steps are done before assessing whether the entity will recover the cost basis of the investment. For equity securities, consideration is given to management's intention and ability to hold the securities until recovery of unrealized losses in assessing potential other-than-temporary impairment. More specifically, considerations used to determine other-than-temporary impairment status for individual equity holdings include the length of time the stock has remained in an unrealized loss position, the percentage of unrealized loss compared to the carrying cost of the stock, dividend reduction or suspension, market analyst reviews and expectations, and other pertinent developments that would affect expectations for recovery or further decline.

In instances when a determination is made that an other-than-temporary impairment exists and the investor does not intend to sell the debt security and it is not more likely than not that it will be required to sell the debt security prior to its anticipated recovery, the other-than-temporary impairment is separated into the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and the amount of the total other-than-temporary impaired related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors for securities available for sale is recognized in other comprehensive income.

The Company's investment portfolio includes primarily bonds issued by U.S. Government sponsored agencies (approximately 60%) and municipalities (approximately 39%) as of September 30, 2012. Most of the municipal bonds are general obligation bonds with maturities or pre-refunding dates within 5 years. The remaining 1% of the portfolio includes mortgage-backed securities issued by Government-sponsored agencies and backed by residential mortgages and a group of equity investments in other financial institutions. The amortized cost and fair value of securities as of September 30, 2012 and December 31, 2011, by contractual maturity, are shown below (in thousands). Expected maturities may differ from contractual maturities because the securities may be called or prepaid with or without prepayment penalties.

Securities Available for Sale	September 30, 2012			
	Amortized Cost	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
Type and maturity				
Obligations of U.S. Government agencies and corporations				
Within one year	\$ 5,401	\$ 5,449	\$ 48	\$
After one year but within five years	50,791	51,428	637	
After five years but within ten years	14,502	14,606	104	
	70,694	71,483	789	
Obligations of state and political subdivisions				
Within one year	12,006	12,066	60	
After one year but within five years	32,873	33,196	339	(16)
After five years but within ten years	2,537	2,760	223	
After ten years	923	931	8	
	48,339	48,953	630	(16)
Mortgage-backed securities	3,225	3,266	41	
Equity securities	985	1,035	156	(106)
Total	\$ 123,243	\$ 124,737	\$ 1,616	\$ (122)

Securities Available for Sale	December 31, 2011			
	Amortized Cost	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
Type and maturity				

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<u>Obligations of U.S. Government agencies and corporations</u>				
Within one year	\$ 2,918	\$ 2,947	\$ 29	\$
After one year but within five years	51,629	52,202	584	(11)
After five years but within ten years	12,497	12,539	42	
	67,044	67,688	655	(11)
<u>Obligations of state and political subdivisions</u>				
Within one year	11,076	11,154	78	
After one year but within five years	21,944	22,289	369	(24)
After five years but within ten years	3,976	4,147	173	(2)
	36,996	37,590	620	(26)
<u>Corporate notes</u>				
After one year but within five years	1,000	1,004	4	
	1,000	1,004	4	
Mortgage-backed securities	4,035	4,109	74	
Equity securities	985	890	97	(192)
Total	\$ 110,060	\$ 111,281	\$ 1,450	\$ (229)

Table of Contents

The following table shows gross unrealized losses and fair value, aggregated by category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2012 and December 31, 2011 (in thousands):

	Unrealized Losses at September 30, 2012					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of state and political subdivisions	\$ 6,213	\$ (16)	\$	\$	\$ 6,213	\$ (16)
Debt securities	6,213	(16)			6,213	(16)
Equity securities	40	(2)	244	(104)	284	(106)
Total temporarily impaired securities	\$ 6,253	\$ (18)	\$ 244	\$ (104)	\$ 6,497	\$ (122)

	Unrealized Losses at December 31, 2011					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. Government agencies and corporations	\$ 6,489	\$ (11)	\$	\$	\$ 6,489	\$ (11)
Obligations of state and political subdivisions	4,321	(26)			4,321	(26)
Debt securities	10,810	(37)			10,810	(37)
Equity securities	423	(80)	232	(112)	655	(192)
Total temporarily impaired securities	\$ 11,233	\$ (117)	\$ 232	\$ (112)	\$ 11,465	\$ (229)

The unrealized losses noted above are considered to be temporary impairments. There are 17 debt securities that were in an unrealized loss position on September 30, 2012, but none that have had unrealized losses for more than 12 months. We believe that the decline in the value of our debt securities is due only to interest rate fluctuations, rather than erosion of quality. As a result, we also believe that the payment of contractual cash flows, including principal repayment, is not at risk. As management does not intend to sell the securities, does not believe the Company will be required to sell the securities before recovery and expects to recover the entire amortized cost basis, none of the debt securities are deemed to be other-than-temporarily impaired.

Equity securities owned by the Company consist of common stock of various financial services providers (Bank Stocks) and are evaluated quarterly for evidence of other-than-temporary impairment. There were nine equity securities that were in an unrealized loss position on September 30, 2012, and eight of those that comprise a group of securities with unrealized losses for 12 months or more. Individually, none of these eight equity securities have significant unrealized losses. Of the eight equity securities that have sustained unrealized losses for more than 12 months, six have increased in fair value during the first nine months of 2012, indicating the possibility of full recovery and therefore are deemed to be temporarily impaired. Of the two remaining stocks experiencing sustained unrealized losses, the amount of individual loss is not material and increases in value were noted, at times, in 2012. Management has identified no other-than-temporary impairment as of, or for the periods ended, September 30, 2012 in the equity portfolio. Management continues to track the performance of each stock owned to determine if it is prudent to deem any further other-than-temporary impairment charges. Management has the ability and intent to hold its equity securities until recovery of unrealized losses.

Certain obligations of the U.S. Government and state and political subdivisions are pledged to secure public deposits, securities sold under agreements to repurchase and for other purposes as required or permitted by law. The fair value of the pledged assets amounted to \$28,900,000 and \$25,953,000 at September 30, 2012 and December 31, 2011, respectively.

Table of Contents

In addition to cash received from the scheduled maturities of securities, some investment securities available for sale are sold at current market values during the course of normal operations, and some securities are called pursuant to call features built into the bonds. Following is a summary of proceeds received from all investment securities transactions, and the resulting realized gains and losses (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Gross proceeds from sales of securities	\$	\$	\$	\$
Securities available for sale:				
Gross realized gains from called securities	\$	\$	\$ 2	\$ 6
Gross realized losses				

NOTE 10 Loans and Related Allowance for Credit Losses

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at the outstanding unpaid principal balances, net of any deferred fees or costs and the allowance for loan losses. Interest income on all loans, other than nonaccrual loans, is accrued over the term of the loans based on the amount of principal outstanding. Unearned income is amortized to income over the life of the loans, using the interest method.

The loan portfolio is segmented into commercial and consumer loans. Commercial loans are comprised of the following classes of loans:

(1) commercial, financial and agricultural, (2) commercial real estate, (3) real estate construction, a portion of (4) mortgage loans and (5) obligations of states and political subdivisions. Consumer loans are comprised of a portion of (4) mortgage loans and (6) personal loans.

Loans on which the accrual of interest has been discontinued are designated as non-accrual loans. Accrual of interest on loans is discontinued when the contractual payment of principal or interest has become 90 days past due or reasonable doubt exists as to the full, timely collection of principal or interest. However, it is the Company's policy to continue to accrue interest on loans over 90 days past due as long as they are (1) guaranteed or well secured and (2) there is an effective means of collection in process. When a loan is placed on non-accrual status, all unpaid interest credited to income in the current year is reversed against current period income and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans generally is either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Generally, accruals are resumed on loans only when the obligation is brought fully current with respect to interest and principal, has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

The Company originates loans in the portfolio with the intent to hold them until maturity. At the time the Company no longer intends to hold loans to maturity based on asset/liability management practices, the Company transfers loans from its portfolio to held for sale at fair value. Any write-down recorded upon transfer is charged against the allowance for loan losses. Any write-downs recorded after the initial transfers are recorded as a charge to other non-interest expense. Gains or losses recognized upon sale are included in other non-interest income.

The Company also originates residential mortgage loans with the intent to sell. These individual loans are normally funded by the buyer immediately. The Company maintains servicing rights on these loans, and fair value of the servicing right is carried as a component of other assets.

The allowance for credit losses consists of the allowance for loan losses and the reserve for unfunded lending commitments. The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the consolidated statement of financial condition date and is recorded as a reduction to loans. The reserve for unfunded lending commitments represents management's estimate of losses inherent in its unfunded lending commitments and is recorded in other liabilities on the consolidated statement of financial condition, when necessary. The amount of the reserve for unfunded lending commitments is not material to the consolidated financial statements. The allowance for loan losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance.

For financial reporting purposes, the provision for loan losses charged to current operating income is based on management's estimates, and actual losses may vary from estimates. These estimates are reviewed and adjusted at least quarterly and are reported in earnings in the periods in which they become known.

Table of Contents

Loans included in any class are considered for charge-off when:

1. principal or interest has been in default for 120 days or more and for which no payment has been received during the previous four months;
2. all collateral securing the loan has been liquidated and a deficiency balance remains;
3. a bankruptcy notice is received for an unsecured loan;
4. a confirming loss event has occurred; or
5. the loan is deemed to be uncollectible for any other reason.

The allowance for loan losses is maintained at a level considered adequate to offset probable losses on the Company's existing loans. The analysis of the allowance for loan losses relies heavily on changes in observable trends that may indicate potential credit weaknesses. Management's periodic evaluation of the adequacy of the allowance is based on the Bank's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and may require the Company to recognize additions to the allowance for loan losses based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the level of the allowance for loan losses as of September 30, 2012 to be adequate.

There are two components of the allowance: a specific component for loans that are deemed to be impaired; and a general component for contingencies.

A large commercial loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. (i.e., large loan, or group of like-loans within one relationship, is defined as a commercial/business loan, including business loans secured by 1-4 family properties included in the real estate-mortgage category, with an aggregate outstanding balance in excess of \$150,000, or any other loan that management deems to have similar characteristics to an impaired large loan) Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loans and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial segment loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent. The estimated fair values of substantially all of the Company's impaired loans are measured based on the estimated fair value of the loan's collateral. For commercial loans secured with real estate, estimated fair values are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the current appraisal and the condition of the property. Appraised values may be discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include the estimated costs to sell the property. For commercial loans secured by non-real estate collateral, estimated fair values are determined based on the borrower's financial statements, inventory reports, aging accounts receivable, equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets. For such loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The Bank generally does not separately identify individual consumer segment loans for impairment disclosures, unless such loans are subject to a

restructuring agreement.

Loans whose terms are modified are classified as troubled debt restructurings if the Company grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a below-market interest rate based on the loan's risk characteristics or an extension of a loan's stated maturity date. Nonaccrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for a period of time after modification. Loans classified as troubled debt restructurings are designated as impaired.

Table of Contents

The component of the allowance for contingencies relates to other loans that have been segmented into risk rated categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated quarterly or when credit deficiencies arise, such as delinquent loan payments. Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful and loss. Loans classified as special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified as substandard have one or more well-defined weaknesses that jeopardize the liquidation of the debt. Substandard loans include loans that are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses. Loans not classified are rated pass. Specific reserves may be established for larger, individual classified loans as a result of this evaluation, as discussed above. Remaining loans are categorized into large groups of smaller balance homogeneous loans and are collectively evaluated for impairment. This computation is generally based on historical loss experience adjusted for qualitative factors. The historical loss experience is averaged over a ten-year period for each of the portfolio segments. The ten-year timeframe was selected in order to capture activity over a wide range of economic conditions and has been consistently used for the past six years. The qualitative risk factors are reviewed for relevancy each quarter and include:

1. National, regional and local economic and business conditions, as well as the condition of various market segments, including the underlying collateral for collateral dependent loans;
2. Nature and volume of the portfolio and terms of loans;
3. Experience, ability and depth of lending and credit management and staff;
4. Volume and severity of past due, classified and nonaccrual loans, as well as other loan modifications;
5. Existence and effect of any concentrations of credit and changes in the level of such concentrations; and
6. Effect of external factors, including competition.

Each factor is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss calculation.

Commercial, Financial and Agricultural Lending

The Company originates commercial, financial and agricultural loans primarily to businesses located in its primary market area and surrounding areas. These loans are used for various business purposes, which include short-term loans and lines of credit to finance machinery and equipment purchases, inventory and accounts receivable. Generally, the maximum term for loans extended on machinery and equipment is shorter and does not exceed the projected useful life of such machinery and equipment. Most business lines of credit are written with a five year maturity, subject to an annual review.

Commercial loans are generally secured with short-term assets; however, in many cases, additional collateral, such as real estate, is provided as additional security for the loan. Loan-to-value maximum values have been established by the Company and are specific to the type of collateral. Collateral values may be determined using invoices, inventory reports, accounts receivable aging reports, collateral appraisals, etc.

In underwriting commercial loans, an analysis of the borrower's character, capacity to repay the loan, the adequacy of the borrower's capital and collateral, as well as an evaluation of conditions affecting the borrower, is performed. Analysis of the borrower's past, present and future cash flows is also an important aspect of the Company's analysis.

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Concentration analysis assists in identifying industry specific risk inherent in commercial, financial and agricultural lending. Mitigants include the identification of secondary and tertiary sources of repayment and appropriate increases in oversight.

Commercial loans generally present a higher level of risk than certain other types of loans, particularly during slow economic conditions.

Table of Contents

Commercial Real Estate Lending

The Company engages in commercial real estate lending in its primary market area and surrounding areas. The Company's commercial real estate portfolio is secured primarily by residential housing, commercial buildings, raw land and hotels. Generally, commercial real estate loans have terms that do not exceed 20 years, have loan-to-value ratios of up to 80% of the appraised value of the property and are typically secured by personal guarantees of the borrowers.

As economic conditions deteriorate, the Company reduces its exposure in real estate loans with higher risk characteristics. In underwriting these loans, the Company performs a thorough analysis of the financial condition of the borrower, the borrower's credit history, and the reliability and predictability of the cash flow generated by the property securing the loan. Appraisals on properties securing commercial real estate loans originated by the Company are performed by independent appraisers.

Commercial real estate loans generally present a higher level of risk than certain other types of loans, particularly during slow economic conditions.

Real Estate Construction Lending

The Company engages in real estate construction lending in its primary market area and surrounding areas. The Company's real estate construction lending consists of commercial and residential site development loans, as well as commercial building construction and residential housing construction loans.

The Company's commercial real estate construction loans are generally secured with the subject property, and advances are made in conformity with a pre-determined draw schedule supported by independent inspections. Terms of construction loans depend on the specifics of the project, such as estimated absorption rates, estimated time to complete, etc.

In underwriting commercial real estate construction loans, the Company performs a thorough analysis of the financial condition of the borrower, the borrower's credit history, the reliability and predictability of the cash flow generated by the project using feasibility studies, market data, etc. Appraisals on properties securing commercial real estate loans originated by the Company are performed by independent appraisers.

Real estate construction loans generally present a higher level of risk than certain other types of loans, particularly during slow economic conditions. The difficulty of estimating total construction costs adds to the risk as well.

Mortgage Lending

The Company's real estate mortgage portfolio is comprised of consumer residential mortgages and business loans secured by one-to-four family properties. One-to-four family residential mortgage loan originations, including home equity installment and home equity lines of credit loans, are generated by the Company's marketing efforts, its present customers, walk-in customers and referrals. These loans originate primarily within the Company's market area or with customers primarily from the market area.

The Company offers fixed-rate and adjustable rate mortgage loans with terms up to a maximum of 25-years for both permanent structures and those under construction. The Company's one-to-four family residential mortgage originations are secured primarily by properties located in its primary market area and surrounding areas. The majority of the Company's residential mortgage loans originate with a loan-to-value of 80% or less. Home equity installment loans are secured by the borrower's primary residence with a maximum loan-to-value of 80% and a maximum term of 15 years. Home equity lines of credit are secured by the borrower's primary residence with a maximum loan-to-value of 90% and a maximum term of 20 years.

In underwriting one-to-four family residential real estate loans, the Company evaluates the borrower's ability to make monthly payments, the borrower's repayment history and the value of the property securing the loan. The ability to repay is determined by the borrower's employment history, current financial conditions, and credit background. The analysis is based primarily on the customer's ability to repay and secondarily on the collateral or security. Most properties securing real estate loans made by the Company are appraised by independent fee appraisers. The Company generally requires mortgage loan borrowers to obtain an attorney's title opinion or title insurance, and fire and property insurance (including flood insurance, if necessary) in an amount not less than the amount of the loan. The Company does not engage in sub-prime residential mortgage originations.

Table of Contents

Residential mortgage loans and home equity loans generally present a lower level of risk than certain other types of consumer loans because they are secured by the borrower's primary residence.

Obligations of States and Political Subdivisions

The Company lends to local municipalities and other tax-exempt organizations. These loans are primarily tax-anticipation notes and, as such, carry little risk. Historically, the Company has never had a loss on any loan of this type.

Personal Lending

The Company offers a variety of secured and unsecured personal loans, including vehicle loans, mobile home loans and loans secured by savings deposits as well as other types of personal loans.

Personal loan terms vary according to the type and value of collateral and creditworthiness of the borrower. In underwriting personal loans, a thorough analysis of the borrower's willingness and financial ability to repay the loan as agreed is performed. The ability to repay is determined by the borrower's employment history, current financial conditions and credit background.

Personal loans may entail greater credit risk than do residential mortgage loans, particularly in the case of personal loans which are unsecured or are secured by rapidly depreciable assets, such as automobiles or recreational equipment. In such cases, any repossessed collateral for a defaulted personal loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. In addition, personal loan collections are dependent on the borrower's continuing financial stability and, thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

The following table presents the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Company's internal risk rating system as of September 30, 2012 and December 31, 2011 (in thousands):

	Pass	Special Mention	Substandard	Doubtful	Total
As of September 30, 2012					
Commercial, financial and agricultural	\$ 16,734	\$ 1,151	\$ 1,338	\$	\$ 19,223
Real estate commercial	53,127	9,008	4,084	40	66,259
Real estate construction	10,680	779	893	2,399	14,751
Real estate mortgage	148,454	5,355	1,688	2,839	158,336
Obligations of states and political subdivisions	14,303				14,303
Personal	5,462	10	3		5,475
Total	\$ 248,760	\$ 16,303	\$ 8,006	\$ 5,278	\$ 278,347

	Pass	Special Mention	Substandard	Doubtful	Total
As of December 31, 2011					
Commercial, financial and agricultural	\$ 17,657	\$ 671	\$ 1,089	\$	\$ 19,417
Real estate commercial	48,108	8,898	3,768		60,774
Real estate construction	14,616	1,022	720	1,150	17,508
Real estate mortgage	161,607	7,513	3,758	3,666	176,544
Obligations of states and political subdivisions	8,780				8,780
Personal	6,640	18			6,658
Total	\$ 257,408	\$ 18,122	\$ 9,335	\$ 4,816	\$ 289,681

Table of Contents

The Company has certain loans in its portfolio that are considered to be impaired. It is the policy of the Company to recognize income on impaired loans that have been transferred to nonaccrual status on a cash basis, only to the extent that it exceeds principal balance recovery. Until an impaired loan is placed on nonaccrual status, income is recognized on the accrual basis. Collateral analysis is performed on each impaired loan at least quarterly and results are used to determine if a specific reserve is necessary to adjust the carrying value of each individual loan down to the estimated fair value. Generally, specific reserves are carried against impaired loans based upon estimated collateral value until a confirming loss event occurs or until termination of the credit is scheduled through liquidation of the collateral or foreclosure. Charge off will occur when a confirmed loss is identified. Professional appraisals of collateral, discounted for expected selling costs, are used to determine the charge-off amount. The following tables summarize information regarding impaired loans by portfolio class as of September 30, 2012 and December 31, 2011 (in thousands):

	As of September 30, 2012			As of December 31, 2011		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
Impaired loans						
With no related allowance recorded:						
Commercial, financial and agricultural	\$ 181	\$ 181	\$	\$ 238	\$ 238	\$
Real estate commercial	2,713	2,713		2,312	2,312	
Real estate construction	1,297	1,297		720	720	
Real estate mortgage	362	362		2,254	2,254	
With an allowance recorded:						
Real estate construction	\$ 1,102	\$ 1,102	\$ 284	\$ 1,150	\$ 1,150	\$ 343
Real estate mortgage	2,319	2,319	1,072	2,865	2,865	432
Total:						
Commercial, financial and agricultural	\$ 181	\$ 181	\$	\$ 238	\$ 238	\$
Real estate commercial	2,713	2,713		2,312	2,312	
Real estate construction	2,399	2,399	284	1,870	1,870	343
Real estate mortgage	2,681	2,681	1,072	5,119	5,119	432
	\$ 7,974	\$ 7,974	\$ 1,356	\$ 9,539	\$ 9,539	\$ 775

	Three Months Ended September 30, 2012			Three Months Ended September 30, 2011		
	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Income	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Income
Impaired loans						
With no related allowance recorded:						
Commercial, financial and agricultural	\$ 189	\$ 4	\$	\$ 265	\$ 4	\$
Real estate commercial	2,730	10	3	2,331	29	
Real estate construction	1,297			360	36	
Real estate mortgage	452			2,009	5	
With an allowance recorded:						
Commercial financial and agricultural	\$	\$	\$	\$	\$	\$
Real estate commercial						
Real estate construction	1,108		11	1,150		
Real estate mortgage	2,686			1,049		
Total:						
Commercial, financial and agricultural	\$ 189	\$ 4	\$	\$ 265	\$ 4	\$
Real estate commercial	2,730	10	3	2,331	29	
Real estate construction	2,405		11	1,510	36	
Real estate mortgage	3,138			3,058	5	
	\$ 8,462	\$ 14	\$ 14	\$ 7,164	\$ 74	\$

Table of Contents

	Nine Months Ended September 30, 2012			Nine Months Ended September 30, 2011		
	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Income	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Income
Impaired loans						
With no related allowance recorded:						
Commercial, financial and agricultural	\$ 210	\$ 11	\$	\$ 282	\$ 14	\$
Real estate commercial	2,513	91	3	2,357	97	2
Real estate construction	1,009			305	36	
Real estate mortgage	1,308			2,118	18	3
With an allowance recorded:						
Commercial financial and agricultural	\$	\$	\$	\$	\$	\$
Real estate commercial						
Real estate construction	1,126		11	1,025		
Real estate mortgage	2,592			1,143		
Total:						
Commercial, financial and agricultural	\$ 210	\$ 11	\$	\$ 282	\$ 14	\$
Real estate commercial	2,513	91	3	2,357	97	2
Real estate construction	2,135		11	1,330	36	
Real estate mortgage	3,900			3,261	18	3
	\$ 8,758	\$ 102	\$ 14	\$ 7,230	\$ 165	\$ 5

The following table presents nonaccrual loans by classes of the loan portfolio as of September 30, 2012 and December 31, 2011 (in thousands):

Nonaccrual loans:	September 30, 2012	December 31, 2011
Commercial, financial and agricultural	\$	\$ 2
Real estate commercial	1,094	520
Real estate construction	2,399	1,497
Real estate mortgage	3,653	5,928
Total	\$ 7,146	\$ 7,947

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the past due status as of September 30, 2012 and December 31, 2011 (in thousands):

	September 30, 2012			December 31, 2011			Loans Past Due greater than 90 Days and Accruing
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans	
As of September 30, 2012							
Commercial, financial and agricultural	\$ 1	\$ 4	\$ 198	\$ 203	\$ 19,020	\$ 19,223	\$ 198
Real estate commercial	569	184	2,438	3,191	63,068	66,259	1,344
Real estate construction	14	59	2,354	2,427	12,324	14,751	157
Real estate mortgage	3,624	906	4,286	8,816	149,520	158,336	827
Obligations of states and political subdivisions					14,303	14,303	
Personal	21	24	6	51	5,424	5,475	6
Total	\$ 4,229	\$ 1,177	\$ 9,282	\$ 14,688	\$ 263,659	\$ 278,347	\$ 2,532

Table of Contents

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans	Loans Past Due greater than 90 Days and Accruing
As of December 31, 2011							
Commercial, financial and agricultural	\$ 220	\$ 2	\$ 30	\$ 252	\$ 19,165	\$ 19,417	\$ 30
Real estate commercial	245	466	1,319	2,030	58,744	60,774	799
Real estate construction	278	32	2,030	2,340	15,168	17,508	533
Real estate mortgage	2,871	145	7,303	10,319	166,225	176,544	1,375
Obligations of states and political subdivisions					8,780	8,780	
Personal	50	11	6	67	6,591	6,658	6
Total	\$ 3,664	\$ 656	\$ 10,688	\$ 15,008	\$ 274,673	\$ 289,681	\$ 2,743

The following tables summarize the allowance for loan losses and recorded investments in loans receivable (in thousands):

As of, and for the periods ended, September 30, 2012

	Commercial, financial and agricultural	Real estate - commercial	Real estate - construction	Real estate - mortgage	Personal	Total
Allowance for loan losses:						
Beginning Balance, July 1, 2012	\$ 203	\$ 432	\$ 364	\$ 2,873	\$ 61	\$ 3,933
Charge-offs	(5)			(569)		(574)
Recoveries	1					1
Provisions	(7)	6	(1)	67	(5)	60
Ending balance, September 30, 2012	\$ 192	\$ 438	\$ 363	\$ 2,371	\$ 56	\$ 3,420
Beginning Balance, January 1, 2012	\$ 195	\$ 455	\$ 442	\$ 1,771	\$ 68	\$ 2,931
Charge-offs	(9)			(745)	(1)	(755)
Recoveries	6				1	7
Provisions		(17)	(79)	1,345	(12)	1,237
Ending balance, September 30, 2012	\$ 192	\$ 438	\$ 363	\$ 2,371	\$ 56	\$ 3,420

	Commercial, financial and agricultural	Real estate - commercial	Real estate - construction	Real estate - mortgage	Obligations of states and political subdivisions	Personal	Total
Allowance for loan losses:							
Ending balance	\$ 192	\$ 438	\$ 363	\$ 2,371	\$	\$ 56	\$ 3,420
Ending balance: individually evaluated for impairment	\$	\$	\$ 284	\$ 1,072	\$	\$	\$ 1,356
Ending balance: collectively evaluated for impairment	\$ 192	\$ 438	\$ 79	\$ 1,299	\$	\$ 56	\$ 2,064
Loans, net of unearned interest:							
Ending balance	\$ 19,223	\$ 66,259	\$ 14,751	\$ 158,336	\$ 14,303	\$ 5,475	\$ 278,347

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Ending balance: individually evaluated for impairment	\$ 181	\$ 2,713	\$ 2,399	\$ 2,681	\$	\$	\$ 7,974
Ending balance: collectively evaluated for impairment	\$ 19,042	\$ 63,546	\$ 12,352	\$ 155,655	\$ 14,303	\$ 5,475	\$ 270,373

Table of Contents

As of, and for the periods ended, September 30, 2011

	Commercial, financial and agricultural	Real estate - commercial	Real estate - construction	Real estate - mortgage	Personal	Total
Allowance for loan losses:						
Beginning Balance, July 1, 2011	\$ 145	\$ 459	\$ 431	\$ 1,784	\$ 62	\$ 2,881
Charge-offs	(4)			(35)	(7)	(46)
Recoveries	1			9	2	12
Provisions	19	9	27	4	1	60
Ending balance, September 30, 2011	\$ 161	\$ 468	\$ 458	\$ 1,762	\$ 58	\$ 2,907
Beginning Balance, January 1, 2011	\$ 163	\$ 442	\$ 336	\$ 1,810	\$ 73	\$ 2,824
Charge-offs	(13)			(178)	(11)	(202)
Recoveries	1			9	11	21
Provisions	10	26	122	121	(15)	264
Ending balance, September 30, 2011	\$ 161	\$ 468	\$ 458	\$ 1,762	\$ 58	\$ 2,907

	Commercial, financial and agricultural	Real estate - commercial	Real estate - construction	Real estate - mortgage	Obligations of states and political subdivisions	Personal	Total
Allowance for loan losses:							
Ending balance	\$ 161	\$ 468	\$ 458	\$ 1,762	\$	\$ 58	\$ 2,907
Ending balance: individually evaluated for impairment	\$	\$	\$ 343	\$ 325	\$	\$	\$ 668
Ending balance: collectively evaluated for impairment	\$ 161	\$ 468	\$ 115	\$ 1,437	\$	\$ 58	\$ 2,239
Loans, net of unearned interest:							
Ending balance	\$ 19,785	\$ 59,654	\$ 17,023	\$ 179,960	\$ 8,738	\$ 7,193	\$ 292,353
Ending balance: individually evaluated for impairment	\$ 256	\$ 2,339	\$ 1,870	\$ 3,056	\$	\$	\$ 7,521
Ending balance: collectively evaluated for impairment	\$ 19,529	\$ 57,315	\$ 15,153	\$ 176,904	\$ 8,738	\$ 7,193	\$ 284,832

As of December 31, 2011

	Commercial, financial and agricultural	Real estate - commercial	Real estate - construction	Real estate - mortgage	Obligations of states and political subdivisions	Personal	Total
As of December 31, 2011							
Allowance for loan losses:							
Ending balance	\$ 195	\$ 455	\$ 442	\$ 1,771	\$	\$ 68	\$ 2,931

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Ending balance: individually evaluated for impairment	\$	\$	\$ 343	\$ 432	\$	\$	\$ 775
Ending balance: collectively evaluated for impairment	\$ 195	\$ 455	\$ 99	\$ 1,339	\$	\$ 68	\$ 2,156
Loans, net of unearned interest:							
Ending balance	\$ 19,417	\$ 60,774	\$ 17,508	\$ 176,544	\$ 8,780	\$ 6,658	\$ 289,681
Ending balance: individually evaluated for impairment	\$ 238	\$ 2,312	\$ 1,870	\$ 5,119	\$	\$	\$ 9,539
Ending balance: collectively evaluated for impairment	\$ 19,179	\$ 58,462	\$ 15,638	\$ 171,425	\$ 8,780	\$ 6,658	\$ 280,142

The Company identified no loans that we determined were considered troubled debt restructurings during the periods presented, and did not have any troubled debt restructurings as of September 30, 2012.

NOTE 11 Fair Value Measurements

Fair value measurement and disclosure guidance defines fair value as the price that would be received to sell an asset or transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. Additional guidance is provided on determining when the volume and level of activity for the asset or liability has significantly decreased. The guidance also includes guidance on identifying circumstances when a transaction may not be considered orderly.

Table of Contents

Fair value measurement and disclosure guidance provides a list of factors that a reporting entity should evaluate to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed, and significant adjustments to the related prices may be necessary to estimate fair value in accordance with fair value measurement and disclosure guidance.

This guidance clarifies that, when there has been a significant decrease in the volume and level of activity for the asset or liability, some transactions may not be orderly. In those situations, the entity must evaluate the weight of the evidence to determine whether the transaction is orderly. The guidance provides a list of circumstances that may indicate that a transaction is not orderly. A transaction price that is not associated with an orderly transaction is given little, if any, weight when estimating fair value.

Fair value measurement and disclosure guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability is not adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction.

Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

Fair value measurement and disclosure guidance requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, the guidance establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 Inputs Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

Level 3 Inputs Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

An asset or liabilities placement in the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

Table of Contents

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

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

Securities Available for Sale. Debt securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurement from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Equity securities classified as available for sale are reported at fair value using Level 1 inputs.

Impaired Loans. Certain impaired loans are reported on a non-recurring basis at the fair value of the underlying collateral since repayment is expected solely from the collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

The following table summarizes financial assets and financial liabilities measured at fair value as of September 30, 2012 and December 31, 2011, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (in thousands). There were no transfers of assets between fair value Level 1 and Level 2 for the quarter ended September 30, 2012.

	September 30, 2012	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Other Unobservable Inputs
Measured at fair value on a recurring basis:				
Debt securities available-for-sale:				
Obligations of U.S. Government agencies and corporations	\$ 71,483	\$	\$ 71,483	\$
Obligations of state and political subdivisions	48,953		48,953	
Mortgage-backed securities	3,266		3,266	
Equity securities available-for-sale	1,035	1,035		
Measured at fair value on a non-recurring basis:				
Impaired loans	2,065			2,065

Table of Contents

	December 31, 2011	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Other Unobservable Inputs
Measured at fair value on a recurring basis:				
Debt securities available-for-sale:				
Obligations of U.S. Government agencies and corporations	\$ 67,688	\$	\$ 67,688	\$
Obligations of state and political subdivisions	37,590		37,590	
Corporate notes	1,004		1,004	
Mortgage-backed securities	4,109		4,109	
Equity securities available-for-sale	890	890		
Measured at fair value on a non-recurring basis:				
Impaired loans	3,240			3,240

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which Level 3 inputs have been used to determine fair value:

September 30, 2012	Fair Value Estimate	Valuation Technique	Unobservable Input	Range
Impaired loans	\$ 2,065	Appraisal of collateral (1)	Appraisal and liquidation adjustments (2)	0% - (7)%

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

Fair Value of Financial Instruments

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, the fair value estimates herein are not necessarily indicative of the amounts the Company could have realized in sales transactions on the dates indicated. The estimated fair value amounts have been measured as of their respective year ends and have not been re-evaluated or updated for purposes of these consolidated financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different from the amounts reported at each quarter end.

The information presented below should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is provided only for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful.

The following describes the estimated fair value of the Company's financial instruments as well as the significant methods and assumptions used to determine these estimated fair values.

Carrying values approximate fair value for cash and due from banks, interest-bearing demand deposits with banks, federal funds sold, restricted stock in the Federal Home Loan Bank, interest receivable, non-interest bearing demand deposits, securities sold under agreements to repurchase, and interest payable.

Interest bearing time deposits with banks The estimated fair value is determined by discounting the contractual future cash flows, using the rates currently offered for deposits of similar remaining maturities.

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Securities Available for Sale Debt securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurement from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Equity securities classified as available for sale are reported at fair value using Level 1 inputs.

Table of Contents

Loans For variable-rate loans that reprice frequently and which entail no significant changes in credit risk, carrying values approximated fair value. Substantially all commercial loans and real estate mortgages are variable rate loans. The fair value of other loans (i.e. consumer loans and fixed-rate real estate mortgages) are estimated by calculating the present value of the cash flow difference between the current rate and the market rate, for the average maturity, discounted quarterly at the market rate.

Mortgage servicing rights The estimated fair value is determined by applying a multiple of the annual servicing fee to the original balance of each loan in the servicing portfolio. The multiple is determined based upon rate, maturity and prepayment assumptions.

Fixed rate time deposits The estimated fair value is determined by discounting the contractual future cash flows, using the rates currently offered for deposits of similar remaining maturities.

Long-term debt and other interest bearing liabilities The fair values of long-term debt are estimated using discounted cash flow analysis, based on incremental borrowing rates for similar types of borrowing arrangements.

Commitments to extend credit and letters of credit The fair value of commitments to extend credit is estimated using the fees currently charged to enter into similar agreements, taking into account market interest rates, the remaining terms and present credit-worthiness of the counterparties. The fair value of guarantees and letters of credit is based on fees currently charged for similar agreements.

The estimated fair values of the Company's financial instruments are as follows (in thousands):

Financial Instruments

(in thousands)

	September 30, 2012		December 31, 2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
Cash and due from banks	\$ 9,239	\$ 9,239	\$ 12,074	\$ 12,074
Interest bearing deposits with banks	7,608	\$ 7,608	2,100	2,100
Interest bearing time deposits with banks	847	850	1,096	1,111
Securities	124,737	124,737	111,281	111,281
Restricted investment in FHLB stock	1,387	1,387	1,700	1,700
Total loans, net of allowance for loan losses	274,927	282,910	286,750	296,891
Mortgage servicing rights	72	72		
Accrued interest receivable	1,730	1,730	1,811	1,811
Financial liabilities:				
Non-interest bearing deposits	66,080	66,080	64,751	64,751
Interest bearing deposits	327,229	331,985	321,914	327,857
Securities sold under agreements to repurchase	4,268	4,268	3,500	3,500
Other interest bearing liabilities	1,282	1,287	1,244	1,251
Accrued interest payable	448	448	421	421
Off-balance sheet financial instruments:				
Commitments to extend credit				
Letters of credit				

The following presents the carrying amount, fair value and placement in the fair value hierarchy of the Company's financial instruments not previously disclosed as of September 30, 2012. This table excludes financial instruments for which the carrying amount approximates fair value.

Table of Contents

			(Level 1) Quoted Prices in Active Markets for Identical Assets or Liabilities	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Other Unobservable Inputs
	Carrying Amount	Fair Value			
September 30, 2012					
Financial instruments Assets					
Interest bearing time deposits with banks	\$ 847	\$ 850	\$	\$ 850	\$
Loans, net of allowance for loan losses	274,927	282,910			282,910
Financial instruments Liabilities					
Interest bearing deposits	327,229	331,985		331,985	
Other interest bearing liabilities	1,282	1,287		1,287	

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward Looking Statements:

The Private Securities Litigation Reform Act of 1995 contains safe harbor provisions regarding forward-looking statements. When used in this discussion, the words believes, anticipates, contemplates, expects, and similar expressions are intended to identify forward-looking statements.

Such statements are subject to certain risks and uncertainties which could cause actual results, performance or achievements expressed or implied by such forward-looking statements to differ materially from those projected. Those risks and uncertainties include changes in interest rates and their impact on the level of deposits, loan demand and value of loan collateral, changes in the market value of the securities portfolio, increased competition from other financial institutions, governmental monetary policy, legislation and changes in banking regulations, changes in levels of FDIC deposit insurance premiums and assessments, risks associated with opening a new branch, the ability to control costs and expenses, and general economic conditions. The Company undertakes no obligation to update such forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Critical Accounting Policies:

Disclosure of the Company's significant accounting policies is included in the notes to the consolidated financial statements of the Company's Annual Report on Form 10-K for the year ended December 31, 2011. Some of these policies require significant judgments, estimates, and assumptions to be made by management, most particularly in connection with determining the provision for loan losses and the appropriate level of the allowance for loan losses, as well as management's evaluation of the investment portfolio for other-than-temporary impairment. There have been no changes in critical accounting policies since December 31, 2011.

General:

The following discussion relates to the consolidated financial condition of the Company as of September 30, 2012, as compared to December 31, 2011, and the consolidated results of operations for the three and nine months ended September 30, 2012, compared to the same periods in 2011.

This discussion should be read in conjunction with the interim consolidated financial statements and related notes included herein.

Overview:

Juniata Valley Financial Corp. is a Pennsylvania corporation organized in 1983 to become the holding company of The Juniata Valley Bank. The Bank is a state-chartered bank headquartered in Mifflintown, Pennsylvania. Juniata Valley Financial Corp. and its subsidiary bank derive substantially all of their income from banking and bank-related services, including interest earned on residential real estate, commercial mortgage, commercial and consumer loans, interest earned on investment securities and fee income from deposit services and other financial services to its customers through 12 locations in central Pennsylvania. Juniata Valley Financial Corp. also owns 39.16% of the Liverpool Community Bank (LCB), located in Liverpool, Pennsylvania. The Company accounts for LCB as an unconsolidated subsidiary using the equity method of accounting.

Table of Contents

Financial Condition:

As of September 30, 2012, total assets increased by \$7.4 million, or 1.7%, as compared to December 31, 2011. Deposits increased by \$6.6 million, with non-interest bearing deposits increasing by \$1.3 million and interest-bearing deposits increasing by \$5.3 million.

The table below shows changes in deposit volumes by type of deposit (in thousands of dollars) between December 31, 2011 and September 30, 2012.

	September 30, 2012	December 31, 2011	Change \$	%
Deposits:				
Demand, non-interest bearing	\$ 66,080	\$ 64,751	\$ 1,329	2.1%
NOW and money market	97,188	93,056	4,132	4.4%
Savings	56,621	50,715	5,906	11.6%
Time deposits, \$100,000 and more	34,764	33,033	1,731	5.2%
Other time deposits	138,656	145,110	(6,454)	(4.4%)
Total deposits	\$ 393,309	\$ 386,665	\$ 6,644	1.7%

Overall, total loans decreased by \$11.3 million, between December 31, 2011 and September 30, 2012, as shown in the table below (in thousands of dollars). The largest dollar reduction by class occurred in the real estate mortgage category, as more individual borrowers were attracted to the secondary market by lower loan rates.

	September 30, 2012	December 31, 2011	Change \$	%
Loans:				
Commercial, financial and agricultural	\$ 19,223	\$ 19,417	\$ (194)	(1.0%)
Real estate commercial	66,259	60,774	5,485	9.0%
Real estate construction	14,751	17,508	(2,757)	(15.7%)
Real estate mortgage	158,336	176,544	(18,208)	(10.3%)
Obligations of states and political subdivisions	14,303	8,780	5,523	62.9%
Personal	5,475	6,658	(1,183)	(17.8%)
Total loans	\$ 278,347	\$ 289,681	(\$ 11,334)	(3.9%)

A summary of the activity in the allowance for loan losses for each of the nine-month periods ended September 30, 2012 and 2011 (in thousands) are presented below.

	Periods Ended September 30,	
	2012	2011
Balance of allowance January 1	\$ 2,931	\$ 2,824
Loans charged off	(755)	(202)
Recoveries of loans previously charged off	7	21
Net charge-offs	(748)	(181)
Provision for loan losses	1,237	264
Balance of allowance end of period	\$ 3,420	\$ 2,907

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Ratio of net charge-offs during period to average loans outstanding	0.26%	0.06%
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As of September 30, 2012, the Company evaluated its large commercial loan relationships and other significant loans for impairment. Of the eleven loan relationships considered to be impaired, there were three loan relationships with respect to which management determined that it is probable that principal and interest will not be collected in full and for which specific reserves were deemed necessary. These conclusions were based upon the receipt of updated appraisals on real estate collateral-dependent loans within these relationships. Following is a discussion describing the situation surrounding each relationship.

Table of Contents

One loan relationship has an aggregate outstanding balance of \$1,240,000 and has been recognized as being impaired for over a year. Based upon recent appraisals that have been appropriately discounted, a specific reserve of \$239,000 has been established. Accordingly, a specific allocation has been included within the allowance for loan losses, adjusting the carrying value of these loans to a fair value of \$1,001,000.

The second loan relationship with a balance of \$1,979,000, was newly identified as impaired as of December 31, 2011. Collateral includes two residential properties along with raw land. The borrower purchased the raw land in 2005 with the intention to sub-divide and develop. While the property had not yet been developed, the borrower was servicing the debt satisfactorily until late in 2011, when financial constraints prevented the borrower from making scheduled payments, and the loan became more than 90 days past due at December 31, 2011. A collateral analysis was performed at that time, using certified appraisals dated two years earlier. It was determined, based on appropriate discounting against those appraisals, that a specific reserve of \$107,000 was necessary. New appraisals were ordered in the first quarter of 2012 and received in early April. Because development has not begun on this property and there are no immediate plans to begin development, the updated appraisal determined that the property's highest and best use is as farmland, instead of as development property as set forth in the previous appraisal; as a result, the appraised value of the property declined significantly. Based on this updated information, and the value of the residential properties, it was determined that it would be prudent to recognize an additional specific reserve of \$976,000 with respect to this relationship as of the end of the first quarter 2012. During the second and third quarters of 2012, the borrower has made payments on the loan, reducing the level of specific reserve needed by \$57,000, resulting in a total specific reserve on this loan relationship of \$1,026,000. Management believes that, based on the commitment and character of the borrower, the location of the property and other observable factors, the property will eventually be developed, although it is not certain when development will occur, or whether the ultimate loss on the relationship will be less than the amount of the specific reserve.

The third loan relationship has an aggregate outstanding balance of \$202,000, with the amount of the impairment measured at \$91,000, based on a recent offer on the property held for collateral.

Management believes that the specific reserves carried are adequate to cover potential future losses related to these relationships. Other loans evaluated for impairment have an aggregate outstanding balance of \$4,553,000, but it was determined that there is sufficient collateral to expect full repayment, and no specific reserves were recorded. There are no other material loans classified as loss, doubtful, substandard, or special mention which management expects to significantly impact future operating results, liquidity or capital resources. Following is a summary of the Bank's non-performing loans at September 30, 2012 as compared to December 31, 2011.

<i>(Dollar amounts in thousands)</i>	September 30, 2012	December 31, 2011
Non-performing loans		
Nonaccrual loans	\$ 7,146	\$ 7,947
Accruing loans past due 90 days or more	2,532	2,743
Restructured loans		
Total	\$ 9,678	\$ 10,690
Average loans outstanding	\$ 283,514	\$ 293,319
Ratio of non-performing loans to average loans outstanding	3.41%	3.64%

Stockholders' equity increased by \$382,000, or 0.8%, from December 31, 2011 to September 30, 2012. Cash dividends of \$2,793,000 exceeded net income of \$2,765,000 by \$28,000. Securities available for sale increased slightly in market value, representing an increase in equity of \$178,000, net of taxes, while cash received for treasury stock issued for stock option and stock purchase plans added \$153,000 and accounting for stock-based compensation activity increased equity by \$17,000. The purchase of 4,664 shares of stock into treasury reduced equity by \$85,000. An adjustment of \$147,000 was made to equity to record the amortization of the net actuarial loss of the Company's defined benefit retirement plan.

Table of Contents

Management is not aware of any current recommendations of applicable regulatory authorities that, if implemented, would have a material effect on the Company's liquidity, capital resources or operations.

Subsequent to September 30, 2012, the following events took place:

On October 16, 2012, the Board of Directors declared a cash dividend for the fourth quarter of 2012 of \$0.22 per share to shareholders of record on November 15, 2012, payable on December 3, 2012.

Comparison of the Three Months Ended September 30, 2012 and 2011

Operations Overview:

Net income for the third quarter of 2012 was \$1,132,000, a decrease of \$82,000 when compared to the third quarter of 2011. Basic and diluted earnings per share, at \$0.27 in the third quarter of 2012, were 6.9% lower than in the same quarter in 2011. Presented below are selected key ratios for the two periods:

	Three Months Ended September 30,	
	2012	2011
Return on average assets (annualized)	0.99%	1.07%
Return on average equity (annualized)	9.07%	9.57%
Average equity to average assets	10.91%	11.20%
Non-interest income, excluding securities gains, as a percentage of average assets (annualized)	1.09%	0.89%
Non-interest expense as a percentage of average assets (annualized)	2.86%	2.74%

Net Interest Income:

Net interest income was \$3,566,000 for the third quarter of 2012, as compared to \$3,791,000 in the same quarter in 2011. Average earning assets grew by 1.1%, while the net interest margin on a fully tax equivalent basis decreased by 26 basis points.

Interest on loans decreased \$471,000, or 10.7%, in the third quarter of 2012 as compared to the same period in 2011. An average weighted yield decrease of 41 basis points lowered interest income by approximately \$233,000, with the remaining decrease attributable to a lower volume of loans.

Interest earned on investment securities and money market investments decreased \$25,000 in the third quarter of 2012 as compared to the third quarter of 2011, with average balances increasing \$16.3 million during the period. The overall pre-tax yield on the investment securities portfolio decreased during that same timeframe by 42 basis points.

Average interest-bearing deposits increased by \$0.76 million, while average non-interest bearing deposits grew by \$4.2 million. Lower deposit rates paid, which more than offset the increase in the volume of deposits, resulted in a reduction in the cost to fund earning assets, which was reduced by 27 basis points, to 0.85%, in the third quarter of 2012.

Total average earning assets during the third quarter of 2012 were \$419.6 million, compared to \$415.0 million during the third quarter of 2011, yielding 4.25% in 2012 versus 4.77% in 2011. Funding costs for the earning assets were 0.85% and 1.12% for the third quarters of 2012 and 2011, respectively. Net interest margin on a fully tax-equivalent basis for the third quarter of 2012 was 3.57%. For the same period in 2011, the fully-tax equivalent net interest margin was 3.83%.

Table of Contents**AVERAGE BALANCE SHEETS AND NET INTEREST INCOME ANALYSIS**

(Dollars in thousands)

	Three Months Ended September 30, 2012			Three Months Ended September 30, 2011			Increase (Decrease) Due To (6)		
	Average Balance (1)	Interest	Yield/ Rate	Average Balance (1)	Interest	Yield/ Rate	Volume	Rate	Total
ASSETS									
Interest earning assets:									
Taxable loans (5)	\$ 259,277	\$ 3,763	5.80%	\$ 277,610	\$ 4,272	6.14%	\$ (296)	\$ (213)	\$ (509)
Tax-exempt loans	19,585	167	3.39	13,018	129	3.93	58	(20)	38
Total loans	278,862	3,930	5.63	290,628	4,401	6.04	(238)	(233)	(471)
Taxable investment securities	95,380	337	1.41	72,733	329	1.81	80	(72)	8
Tax-exempt investment securities	39,646	190	1.92	34,118	221	2.59	32	(63)	(31)
Total investment securities	135,026	527	1.56	106,851	550	2.06	112	(135)	(23)
Interest bearing deposits	5,689	7	0.49	7,727	8	0.41	(2)	1	(1)
Federal funds sold				9,793	1	0.06	(1)		(1)
Total interest earning assets	419,577	4,464	4.25	414,999	4,960	4.77	(129)	(367)	(496)
Other assets (7)	38,242			38,054					
Total assets	\$ 457,819			\$ 453,053					
LIABILITIES AND STOCKHOLDERS EQUITY									
Interest bearing liabilities:									
Interest bearing demand deposits (2)	\$ 99,986	50	0.20	\$ 96,670	117	0.48	4	(71)	(67)
Savings deposits	57,498	36	0.25	50,958	48	0.37	6	(18)	(12)
Time deposits	174,033	805	1.84	184,645	997	2.14	(55)	(137)	(192)
Other, including short-term borrowings, long-term debt and other interest bearing liabilities	5,016	7	0.56	4,237	7	0.56	1	(1)	
Total interest bearing liabilities	336,533	898	1.06	336,510	1,169	1.38	(44)	(227)	(271)
Non-interest bearing liabilities:									
Demand deposits	65,432			61,328					
Other	5,920			4,482					
Stockholders equity	49,934			50,733					
Total liabilities and stockholders equity	\$ 457,819			\$ 453,053					
Net interest income and net interest rate spread		\$ 3,566	3.19%		\$ 3,791	3.39%	\$ (85)	\$ (140)	\$ (225)
Net interest margin on interest earning assets (3)			3.40%			3.65%			
Net interest income and net interest margin - Tax equivalent basis (4)		\$ 3,750	3.57%		\$ 3,972	3.83%			

Notes:

- 1) Average balances were calculated using a daily average.
- 2) Includes Supernow and money market accounts.
- 3) Net margin on interest earning assets is net interest income divided by average interest earning assets.
- 4) Interest on obligations of states and municipalities is not subject to federal income tax. In order to make the net yield comparable on a fully taxable basis, a tax equivalent adjustment is applied against the tax-exempt income utilizing a federal tax rate of 34%.
- 5) Non-accruing loans are included in the above table until they are charged off.
- 6) The change in interest due to rate and volume has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.
- (7) Includes gross unrealized gains (losses) on securities available for sale.

Provision for Loan Losses:

The provision for loan losses was \$60,000 in each of the third quarters of 2012 and 2011. Management regularly reviews the adequacy of the loan loss reserve and makes assessments as to specific loan impairment, historical charge-off expectations, general economic conditions in the Bank's market area, specific loan quality and other factors. See the earlier discussion in the Financial Condition section, explaining the information used to formulate the significant increase in the provision.

Non-interest Income:

Non-interest income in the third quarter of 2012 was \$1,253,000, compared to \$1,005,000 in the third quarter of 2011, representing an increase of 24.7%.

Table of Contents

Trust fee income was \$24,000, or 22.0%, lower in the third quarter of 2012 as compared to the third quarter of 2011, due to a lower level of estate settlements in the most current quarter. Commissions from sales of non-deposit products in the third quarter of 2012 were \$75,000, or 141.5%, higher than in the same quarter of the previous year.

Reduced fee income from overdraft fees in the third quarter of 2012 as compared to the third quarter of 2011 caused customer service fees to decline by 8.8%. Fees derived from electronic payment activity through the use of debit cards remained steady in the two comparative periods.

The Company began originating mortgages to sell on the secondary market and retain the servicing rights as a strategic objective in 2012 and has been successful in building a servicing portfolio of approximately \$8.2 million as of September 30, 2012. The mortgage servicing right asset is included as a component of other assets, and as of September 30, 2012, was \$72,000. Gains on the sale of mortgage loans is made up of origination and servicing fees collected from the buyer, origination points collected from the borrower and an adjustment to the fair value of the mortgage servicing rights asset. In the third quarter of 2012, the total net gain on the sale of mortgage loans was \$208,000. Non-interest income reflected in the line item fees derived from loan activity increased by an additional \$17,000, or 43.6%, through fees derived primarily as a result of the production of mortgage loans.

As a percentage of average assets, annualized non-interest income, exclusive of net gains on the sale of securities, was 1.09% in the third quarter of 2012 versus 0.89% in the same quarter of 2011.

Non-interest Expense:

Total non-interest expense was \$3,273,000 in the third quarter of 2012, an increase of \$164,000, or 5.3%, as compared to the third quarter of 2011.

Employee compensation expense was relatively unchanged in the third quarter of 2012 compared to the previous year's third quarter, while expense related to employee benefits increased by 49.7%. The increase in benefits expense related to increased costs for employee medical insurance and the Company's defined benefit retirement plan. Data processing expense increased by 8.3% in the third quarter of 2012 versus the third quarter of 2011 resulting from adding additional electronic back room support services. Other non-interest expense categories were relatively stable during the third quarter of 2012 versus the third quarter of 2011.

As a percentage of average assets, annualized non-interest expense was 2.86% and 2.74% in the third quarter of 2012 and 2011, respectively.

Provision for income taxes:

The provision for income taxes in the third quarter of 2012 was \$59,000 lower than in the same time period in 2011, resulting from lower income before income taxes in the 2012 period. The effective tax rate in the third quarter of 2012 was 23.8% versus 25.4% in 2011. The reduction in the effective rate is attributed to the higher percentage of tax-exempt income relative to pre-tax earnings in the third quarter of 2012.

Comparison of the Nine Months Ended September 30, 2012 and 2011

Operations Overview:

Net income for the first nine months of 2012 was \$2,765,000, a decrease of \$779,000, or 22.0%, compared to the first nine months of 2011. A large provision for loan losses was recorded in the first quarter of 2012, reflecting specific reserves recorded on three loan relationships, causing the negative variance to the prior year. Diluted earnings per share were \$0.65 in the first nine months of 2012, representing a decrease of 21.7% from the \$0.83 earned in the first nine months of 2011. Annualized return on average equity for the first nine months in 2012 was 7.42%, compared to the ratio for the same period in the prior year of 9.40%, a decrease of 21.1%. For the nine months ended September 30, annualized return on average assets was 0.81% in 2012, versus 1.06% in 2011.

Table of Contents

Presented below are selected key ratios for the two periods:

	Nine Months Ended September 30,	
	2012	2011
Return on average assets (annualized)	0.81%	1.06%
Return on average equity (annualized)	7.42%	9.40%
Average equity to average assets	10.92%	11.25%
Non-interest income, excluding securities gains, as a percentage of average assets (annualized)	1.02%	0.90%
Non-interest expense as a percentage of average assets (annualized)	2.86%	2.86%

The discussion that follows explains changes in the components of net income when comparing the first nine months of 2012 with the first nine months of 2011.

Net Interest Income:

Net interest income was \$10,986,000 for the first nine months of 2012, as compared to \$11,538,000 in the same period in 2011. Average earning assets grew by 1.9%, while the net interest margin on a fully tax equivalent basis decreased by 26 basis points.

Interest on loans decreased \$1,278,000, or 9.5%, in the first nine months of 2012 as compared to the same period in 2011. An average weighted yield decrease of 38 basis points lowered interest income by approximately \$654,000, with the remaining decrease attributable to a lower volume of loans.

Interest earned on investment securities and money market investments decreased \$30,000 in the first nine months of 2012 as compared to 2011, despite average balances increasing \$18.2 million during the period. The yield on money market investments (federal funds and interest bearing deposits) decreased by 9 basis points in the first nine months of 2012 as compared to the first nine months of 2011, due to the reduction in rates earned on interest bearing balances with other financial institutions. Likewise, the overall pre-tax yield on the investment securities portfolio decreased during that same timeframe by 42 basis points.

Average interest-bearing deposits increased by \$2.3 million, while average non-interest bearing deposits grew by \$8.4 million. Increases in deposits, in addition to the lower general rate environment, contributed to the reduction in the cost to fund earning assets, which was reduced by 27 basis points, to 0.90%, in the first nine months of 2012.

Total average earning assets during the first nine months of 2012 were \$415.2 million, compared to \$407.3 million during the first nine months of 2011, yielding 4.43% in 2012 versus 4.94% in 2011. Funding costs for the earning assets were 0.90% and 1.17% for the first nine months of 2012 and 2011, respectively. Net interest margin on a fully tax-equivalent basis for the first nine months of 2012 was 3.70%. For the same period in 2011, the fully-tax equivalent net interest margin was 3.96%.

Table of Contents**AVERAGE BALANCE SHEETS AND NET INTEREST INCOME ANALYSIS**

(Dollars in thousands)

	Nine Months Ended September 30, 2012			Nine Months Ended September 30, 2011			Increase (Decrease) Due To (6)		
	Average Balance (1)	Interest	Yield/ Rate	Average Balance (1)	Interest	Yield/ Rate	Volume	Rate	Total
ASSETS									
Interest earning assets:									
Taxable loans (5)	\$ 265,142	\$ 11,717	5.89%	\$ 280,699	\$ 13,096	6.23%	\$ (764)	\$ (589)	\$ (1,379)
Tax-exempt loans	18,372	482	3.50	13,156	381	3.87	140	(65)	101
Total loans	283,514	12,199	5.74	293,855	13,477	6.12	(624)	(654)	(1,278)
Taxable investment securities	88,493	1,004	1.51	67,094	894	1.78	229	(119)	110
Tax-exempt investment securities	35,162	554	2.10	33,674	689	2.73	29	(164)	(135)
Total investment securities	123,655	1,558	1.68	100,768	1,583	2.10	258	(283)	(25)
Interest bearing deposits	7,909	23	0.39	4,169	23	0.71	14	(13)	
Federal funds sold	100		0.13	8,545	5	0.08	(7)	2	(5)
Total interest earning assets	415,178	13,780	4.43	407,337	15,088	4.94	(359)	(949)	(1,308)
Other assets (7)	39,517			39,282					
Total assets	\$ 454,695			\$ 446,619					
LIABILITIES AND STOCKHOLDERS EQUITY									
Interest bearing liabilities:									
Interest bearing demand deposits (2)	\$ 97,361	169	0.23	\$ 90,890	320	1.47	31	(181)	(151)
Savings deposits	55,902	104	0.25	49,882	168	0.45	19	(83)	(64)
Time deposits	176,019	2,501	1.90	186,229	3,040	2.18	(150)	(389)	(539)
Other, including short-term borrowings, long-term debt and other interest bearing liabilities	4,526	20	0.59	4,146	22	0.71	1	(3)	(2)
Total interest bearing liabilities	333,808	2,794	1.13	331,147	3,550	1.44	(99)	(657)	(756)
Non-interest bearing liabilities:									
Demand deposits	65,193			60,636					
Other	6,026			4,581					
Stockholders equity	49,668			50,255					
Total liabilities and stockholders equity	\$ 454,695			\$ 446,619					
Net interest income and net interest rate spread		\$ 10,986	3.30%		\$ 11,538	3.50%	\$ (260)	\$ (292)	\$ (552)
Net interest margin on interest earning assets (3)			3.40%			3.65%			
Net interest income and net interest margin -									

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Tax equivalent basis (4)	\$ 11,520	3.70%	\$ 12,090	3.96%
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Notes:

- 1) Average balances were calculated using a daily average.
- 2) Includes Supernow and money market accounts.
- 3) Net margin on interest earning assets is net interest income divided by average interest earning assets.
- 4) Interest on obligations of states and municipalities is not subject to federal income tax. In order to make the net yield comparable on a fully taxable basis, a tax equivalent adjustment is applied against the tax-exempt income utilizing a federal tax rate of 34%.
- 5) Non-accruing loans are included in the above table until they are charged off.
- 6) The change in interest due to rate and volume has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.
- (7) Includes gross unrealized gains (losses) on securities available for sale.

Provision for Loan Losses:

In the first nine months of 2012, the provision for loan losses was \$1,237,000, as compared to a provision of \$264,000 in the first nine months of 2011. Management regularly reviews the adequacy of the loan loss reserve and makes assessments as to specific loan impairment, historical charge-off expectations, general economic conditions in the Bank's market area, specific loan quality and other factors. The increased provision was primarily the result of analysis of the values of collateral securing certain impaired loans. See the earlier discussion in the Financial Condition section, explaining the information and analysis used to arrive at the significant increase in the provision.

Non-interest Income:

Non-interest income in the first nine months of 2012 was \$3,490,000, \$474,000 higher than the \$3,016,000 recorded in the first nine months of 2011.

Table of Contents

Trust fee income was \$11,000, or 3.5%, lower in the first nine months of 2012 as compared to the first nine months of 2011, due primarily to lower estate settlement fees. Commissions from sales of non-deposit products in the first nine months of 2012 were 30.3%, or \$67,000, higher than in the same period of the previous year.

Customer service fees declined by \$58,000, or 5.7%, in the first nine months of 2012 compared to the same period in 2011 as a direct result of fewer overdraft fees assessed on deposit accounts.

The Company began originating mortgages to sell on the secondary market and retain the servicing rights as a strategic objective in 2012 and has been successful in building a servicing portfolio of approximately \$8.2 million as of September 30, 2012. The mortgage servicing right asset is included as a component of other assets, and as of September 30, 2012, was \$72,000. Gains on the sale of mortgage loans is made up of origination and servicing fees collected from the buyer, origination points collected from the borrower and an adjustment to the fair value of the mortgage servicing rights asset. In the nine months ended on September 30, 2012, the total net gain on the sale of mortgage loans was \$420,000. Non-interest income reflected in the line item fees derived from loan activity increased by an additional \$31,000, or 27.0%, through fees derived primarily as a result of the production of mortgage loans.

Income recorded from the equity investment in an unconsolidated subsidiary was \$17,000 lower in the current year nine month period than in the previous year to date. A gain of \$53,000 was recorded in the first nine months of 2012 as a result of a life insurance claim. No such activity occurred in the previous year.

As a percentage of average assets, annualized non-interest income, exclusive of net gains on the sale of securities, was 1.02% in the first nine months of 2012 versus 0.90% in the prior year through September.

Non-interest Expense:

Total non-interest expense increased in the first nine months of 2012 as compared to 2011, by \$166,000, or 1.7%.

An increase in employee benefits expense, due to higher medical insurance and defined benefit costs, was offset by decreases in occupancy, equipment, director compensation, professional fees and FDIC insurance. FDIC insurance premiums decreased by \$49,000 as a result of the re-formulation of assessments by the FDIC, beginning in the second quarter of 2011, effectively reducing costs for well-capitalized banks. Sales of properties carried as other real estate generated net losses of \$3,000 in the first nine months of 2012, as compared to a net gain of \$28,000 during the same period one year earlier.

As a percentage of average assets, annualized non-interest expense was 2.86% in the first nine months of 2012 and 2011.

Provision for income taxes:

The provision for income taxes in the first nine months of 2012 was \$736,000, versus \$1,174,000 in the same time period in 2011. The reduction in tax expense related to reduced pre-tax income. The effective tax rate in the first nine months of 2012 was 21.0% versus 24.9% in 2011. The reduction in the effective rate is attributed to the higher percentage of tax-exempt income relative to pre-tax earnings in the first nine months of 2012.

Liquidity:

The objective of liquidity management is to ensure that sufficient funding is available, at a reasonable cost, to meet the ongoing operational cash needs of the Company and to take advantage of income producing opportunities as they arise. While the desired level of liquidity will vary depending upon a variety of factors, it is the primary goal of the Company to maintain a high level of liquidity in all economic environments. Principal sources of asset liquidity are provided by securities maturing in one year or less, other short-term investments such as federal funds sold and cash and due from banks. Liability liquidity, which is more difficult to measure, can be met by attracting deposits and maintaining the core deposit base. The Company is a member of the Federal Home Loan Bank of Pittsburgh for the purpose of providing short-term liquidity when other sources are unable to fill these needs. During the first nine months of 2012, average borrowings from the Federal Home Loan Bank were \$30,000. As of September 30, 2012, the Company had no long-term debt and had unused borrowing capacity with the Federal Home Loan Bank of \$129 million.

Table of Contents

Funding derived from securities sold under agreements to repurchase (accounted for as collateralized financing transactions) is available through corporate cash management accounts for business customers. This product gives the Company the ability to pay interest on corporate checking accounts.

In view of the sources previously mentioned, management believes that the Company's liquidity is capable of providing the funds needed to meet loan demand.

Liquidity must also be managed at the parent company level. For safety and soundness reasons, banking regulations limit the amount of cash that can be transferred from subsidiary banks to the parent company in the form of loans and dividends. Generally, these limitations are based on the subsidiary banks' regulatory capital levels and their net income. Management continues to monitor the liquidity and capital needs of the parent company and will implement appropriate strategies, as necessary, to remain adequately capitalized and to meet its cash needs.

Off-Balance Sheet Arrangements:

The Company's consolidated financial statements do not reflect various off-balance sheet arrangements that are made in the normal course of business, which may involve some liquidity risk, credit risk, and interest rate risk. These commitments consist mainly of loans approved but not yet funded, unused lines of credit and outstanding letters of credit. These commitments were made using the same credit standards as on-balance sheet instruments. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the commitment terms. Letters of credit are conditional commitments issued to guarantee the financial performance obligation of a customer to a third party. Unused commitments and letters of credit at September 30, 2012 were \$41,551,000 and \$1,202,000, respectively.

Because these instruments have fixed maturity dates, and because many of them will expire without being drawn upon, they do not generally present any significant liquidity risk to the Company. Management believes that any amounts actually drawn upon can be funded in the normal course of operations. The Company has no investment in or financial relationship with any unconsolidated entities that are reasonably likely to have a material effect on liquidity or the availability of capital resources.

Interest Rate Sensitivity:

Interest rate sensitivity management is overseen by the Asset/Liability Management Committee. This process involves the development and implementation of strategies to maximize net interest margin, while minimizing the earnings risk associated with changing interest rates. Traditional gap analysis identifies the maturity and re-pricing terms of all assets and liabilities. A simulation analysis is used to assess earnings and capital at risk from movements in interest rates. See Item 3 for a description of the complete simulation process and results.

Capital Adequacy:

Bank regulatory authorities in the United States issue risk-based capital standards. These capital standards relate a banking company's capital to the risk profile of its assets and provide the basis by which all banking companies and banks are evaluated in terms of capital adequacy. The risk-based capital standards require all banks to have Tier 1 capital of at least 4% and total capital, including Tier 1 capital, of at least 8% of risk-adjusted assets. Tier 1 capital includes common stockholders' equity and qualifying perpetual preferred stock together with related surpluses and retained earnings. Total capital is comprised of Tier 1 capital, limited life preferred stock, qualifying debt instruments, and the reserves for possible loan losses. Banking regulators have also issued leverage ratio requirements. The leverage ratio requirement is measured as the ratio of Tier 1 capital to adjusted average assets. At September 30, 2012, the Bank exceeded the regulatory requirements to be considered a "well capitalized" financial institution, i.e., a leverage ratio exceeding 5%, Tier 1 capital exceeding 6% and total capital exceeding 10%.

The federal banking regulatory agencies have proposed implementing the so-called Basel III capital standards. The Basel III proposals would change required levels of capital and how banks calculate their regulatory capital and revise and harmonize the rules for calculating risk-weighted assets to enhance risk sensitivity and address weaknesses that have been identified over the past several years. The proposals would increase the minimum levels of required capital, narrow the definition of capital, and increase the risk weights of assets for various asset classes.

Specifically, fully phased-in capital standards under Basel III would require banks to maintain more capital than the minimum levels required under current regulatory capital standards. The new requirements would (i) include a new minimum common equity Tier 1 capital ratio of 4.50% of risk-weighted assets, (ii) raise the minimum Tier 1 capital ratio from 4.00% to 6.00% of risk-weighted assets, (iii) retain the current minimum Total capital ratio of 8.00% of risk-weighted assets and the minimum Tier 1 leverage capital ratio at 4.00% of average assets and (iv) Introduce a capital conservation buffer of 2.50% above the minimum risk-based capital requirements; the capital conservation buffer must be maintained to avoid restrictions on capital distributions and certain discretionary bonus payments.

Table of Contents

The new minimum regulatory capital requirements would be phased in from January 1, 2013 through January 1, 2016. The capital conservation buffer would be phased in from January 1, 2016 through January 1, 2019. As of September 30, 2012, the Corporation believes its current capital levels would meet the fully-phased in minimum capital requirements, including capital conservation buffers, as proposed in the Basel III capital standards

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the exposure to economic loss that arises from changes in the values of certain financial instruments. The types of market risk exposures generally faced by financial institutions include equity market price risk, interest rate risk, foreign currency risk and commodity price risk. Due to the nature of its operations, only equity market price risk and interest rate risk are significant to the Company.

Equity market price risk is the risk that changes in the values of equity investments could have a material impact on the financial position or results of operations of the Company. The Company's equity investments consist of common stocks of publicly traded financial institutions.

Recent declines and volatility in the values of financial institution stocks have significantly reduced the likelihood of realizing significant gains in the near-term. Although the Company has realized occasional gains from this portfolio in the past, the primary objective of the portfolio is to achieve value appreciation in the long term while earning consistent attractive after-tax yields from dividends. The carrying value of the financial institutions stocks accounted for 0.2% of the Company's total assets as of September 30, 2012. Management performs an impairment analysis on the entire investment portfolio, including the financial institutions stocks, on a quarterly basis. For the nine months ended September 30, 2012, no other-than-temporary impairment was identified. There is no assurance that further declines in market values of the common stock portfolio in the future will not result in other-than-temporary impairment charges, depending upon facts and circumstances present.

The equity investments in the Company's portfolio had an adjusted cost basis of approximately \$985,000 and a fair value of \$1,035,000 at September 30, 2012. Net unrealized gains in this portfolio were approximately \$50,000 at September 30, 2012.

In addition to its equity portfolio, the Company's investment management and trust services revenue could be impacted by fluctuations in the securities markets. A portion of the Company's trust revenue is based on the value of the underlying investment portfolios. If securities values decline, the Company's trust revenue could be negatively impacted.

Interest rate risk creates exposure in two primary areas. First, changes in rates have an impact on the Company's liquidity position and could affect its ability to meet obligations and continue to grow. Second, movements in interest rates can create fluctuations in the Company's net interest income and changes in the economic value of equity.

The primary objective of the Company's asset-liability management process is to maximize current and future net interest income within acceptable levels of interest rate risk while satisfying liquidity and capital requirements. Management recognizes that a certain amount of interest rate risk is inherent, appropriate and necessary to ensure profitability. A simulation analysis is used to assess earnings and capital at risk from movements in interest rates. The model considers three major factors of (1) volume differences, (2) repricing differences, and (3) timing in its income simulation. As of the most recent model run, data was disseminated into appropriate repricing buckets, based upon the static position at that time. The interest-earning assets and interest-bearing liabilities were assigned a multiplier to simulate how much that particular balance sheet item would re-price when interest rates change. Finally, the estimated timing effect of rate changes is applied, and the net interest income effect is determined on a static basis (as if no other factors were present). As the table below indicates, based upon rate shock simulations on a static basis, the Company's balance sheet is relatively rate-neutral as rates decline. Each 100 basis point increase results in approximately \$363,000 decline in net interest income in the static environment. This negative effect of rising rates is offset to a large degree by the positive effect of imbedded options that include loans floating above their floors and likely internal deposit pricing strategies. After applying the effects of options, over a one-year period, the net effect of an immediate 100, 200, 300 and 400 basis point rate increase would change net interest income by \$13,000, \$49,000, \$(938,000) and \$(1,053,000), respectively. Rate shock modeling was done for a declining rate of 25 basis points only, as the federal funds target rate currently is between zero and 0.25%. As the table below indicates, the net effect of interest rate risk on net interest income is essentially neutral in a rising rate environment through a 200 basis point increase. Juniata's rate risk policies provide for maximum limits on net interest income that can be at risk for 100 through 400 basis point changes in interest rates.

Table of Contents

Effect of Interest Rate Risk on Net Interest Income

(Dollars in thousands)

Change in	Change in Net	Change in Net	
Interest Rates	Interest	Interest	Total Change in
(Basis Points)	Income	Income	Net Interest
	Due to Interest	Due to Imbedded	Income
	Rate Risk (Static)	Options	
400	\$ (1,450)	\$ 397	\$ (1,053)
300	(1,088)	150	(938)
200	(725)	774	49
100	(363)	376	13
0			
-25	91	(37)	54

The net interest income at risk position remained within the guidelines established by the Company's asset/liability policy.

No material change has been noted in the Bank's equity value at risk. Please refer to the Company's Annual Report on Form 10-K dated as of December 31, 2011, under the heading, Management's Discussion and Analysis of Financial Condition and Results of Operations for further discussion of this topic.

Item 4. Controls and Procedures**Disclosure Controls and Procedures**

As of September 30, 2012, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as defined by the Securities Exchange Act of 1934 (Exchange Act), Rule 13a-15(e). Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in Company reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. These controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential conditions, regardless of how remote.

Attached as Exhibits 31 and 32 to this quarterly report are certifications of the Chief Executive Officer and the Chief Financial Officer required by Rule 13a-14(a) and rule 15d-14(a) of the Exchange Act. This portion of the Company's quarterly report includes the information concerning the controls evaluation referred to in the certifications and should be read in conjunction with the certifications for a more complete understanding of the topics presented.

Table of Contents

Changes in Internal Control Over Financial Reporting

There were no significant changes in the Company's internal control over financial reporting during the fiscal quarter ended September 30, 2012, that has materially affected, or is reasonably likely to materially affect, the internal controls over financial reporting.

Table of Contents**PART II OTHER INFORMATION**

Item 1. LEGAL PROCEEDINGS

In the opinion of management of the Company, there are no legal proceedings pending to which the Company or its subsidiary is a party or to which its property is subject, which, if determined adversely to the Company or its subsidiary, would be material in relation to the Company's or its subsidiary's financial condition. There are no proceedings pending other than ordinary routine litigation incident to the business of the Company or its subsidiary. In addition, no material proceedings are pending or are known to be threatened or contemplated against the Company or its subsidiary by government authorities.

Item 1A. RISK FACTORS

There have been no material changes to the risk factors that were disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The Company purchased shares of its common stock in the quarter ended September 30, 2012 as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1)
July 1-31, 2012		\$		88,186
August 1-31, 2012	4,664	18.20	4,664	83,522
September 1-30, 2012				83,522
Totals	4,664		4,664	83,522

On March 23, 2001, the Company announced plans to buy back 100,000 (200,000 on a post-split basis) shares of its common stock. There is no expiration date to this buyback plan, but subsequent to the initial plan, the Board of Directors authorized the repurchase of 400,000 additional shares in 2005 and then authorized 200,000 additional shares in September of 2008. As of November 8, 2012, the number of shares that may yet be purchased under the program was 83,522. No repurchase plan or program expired during the quarter. The Company has no stock repurchase plan or program that it has determined to terminate prior to expiration or under which it does not intend to make further purchases.

Certain regulatory restrictions exist regarding the ability of the Bank to transfer funds to the Company in the form of cash dividends, loans or advances. Please refer to the Company's Annual Report on Form 10-K dated as of December 31, 2011, under the heading, "Supervision and Regulation" for further discussion of this topic. At September 30, 2012, \$38,872,000 of undistributed earnings of the Bank, included in the consolidated stockholders' equity, was available for distribution to the Company as dividends without prior regulatory approval, subject to the regulatory capital requirements above.

Item 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

Item 5. OTHER INFORMATION

None.

39

Table of Contents

Item 6. EXHIBITS

- 3.1 Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 4.1 to the Company's Form S-3 Registration Statement No. 333-129023 filed with the SEC on October 14, 2005)
- 3.2 Bylaws (incorporated by reference to Exhibit 3.2 to the Company's report on Form 8-K filed with the SEC on December 21, 2007)
- 3.3 Bylaw Amendment (incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC on February 28, 2012)
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of President and Chief Executive Officer
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
- 32.1 Section 1350 Certification of President and Chief Executive Officer
- 32.2 Section 1350 Certification of Chief Financial Officer
- 101.LAB** XBRL Taxonomy Extension Label Linkbase
- 101.PRE** XBRL Taxonomy Extension Presentation Linkbase
- 101.INS** XBRL Instance Document
- 101.SCH** XBRL Taxonomy Extension Schema
- 101.CAL** XBRL Taxonomy Extension Calculation Linkbase
- 101.DEF** XBRL Taxonomy Extension Definition Linkbase

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

Juniata Valley Financial Corp.
(Registrant)

Date 11-09-2012

By /s/ Marcie A. Barber
Marcie A. Barber, President and Chief
Executive Officer (Principal Executive
Officer)

Date 11-09-2012

By /s/ JoAnn N. McMinn
JoAnn N. McMinn, Chief Financial
Officer (Principal Accounting Officer
and Principal Financial Officer)