

Strategic growth.  
Piece by piece.





To enhance the franchise value of the bank so that our shareholders, customers, employees and the communities we serve benefit from our strategic growth, commitment to excellence, quality of service, capital financing and technological enhancements, we will continue to seek opportunities in this improving economic environment that have tangible value to our business model with a view toward increasing shareholder value.

In 2013, the formation of our holding company, Empire Bancorp, Inc., exemplified this future positioning. It enables us to make targeted acquisitions, offer a variety of financial services and raise funds through both equity and debt. While our total assets have grown significantly over our first six years, our greatest asset is our employees — their dedication, hard work and team spirit enhance our brand and name recognition.

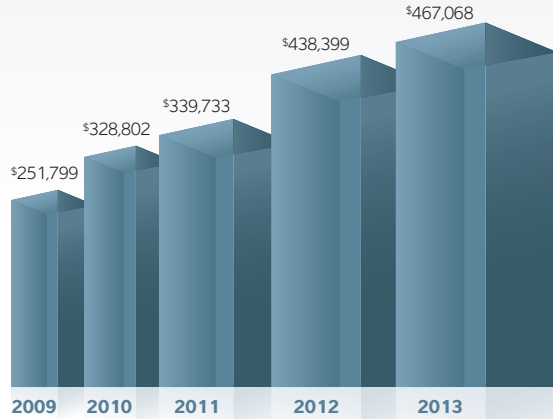
We greatly value the commitment that you have made to us and it is our primary goal to reward you with a return on your personal investment that you deserve.

Douglas C. Manditch  
*Empire Bancorp, Inc.*  
*Chairman of the Board and*  
*Chief Executive Officer*

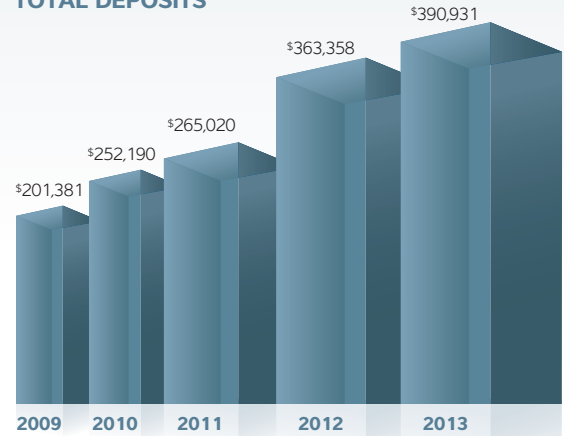
## SELECTED FINANCIAL DATA

(dollars in thousands)

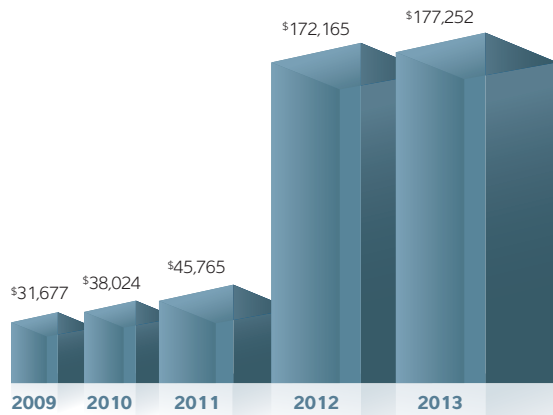
### TOTAL ASSETS



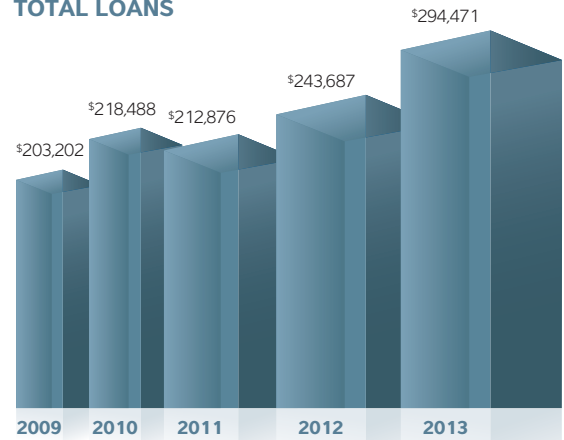
### TOTAL DEPOSITS



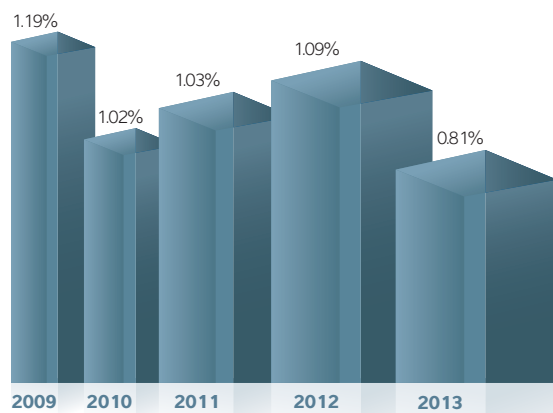
### TOTAL DEMAND DEPOSITS



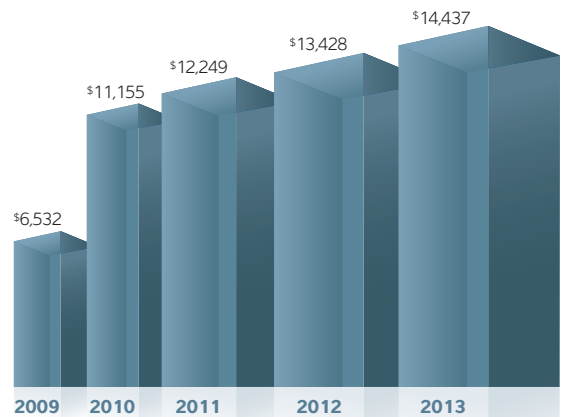
### TOTAL LOANS



### NON-PERFORMING LOANS TO TOTAL LOANS



### NET INTEREST INCOME



## FINANCIAL HIGHLIGHTS

(dollars in thousands, except per share data)

For the year ended December 31,	2013	2012	2011	2010	2009
<b>FINANCIAL CONDITION DATA:</b>					
Total Assets	\$ 467,068	\$ 438,399	\$ 339,733	\$ 328,802	\$ 251,799
Total Loans	\$ 294,471	\$ 243,687	\$ 212,876	\$ 218,488	\$ 203,202
Total Deposits	\$ 390,931	\$ 363,358	\$ 265,020	\$ 252,190	\$ 201,381
Total Demand Deposits	\$ 177,252	\$ 172,165	\$ 45,765	\$ 38,024	\$ 31,677
Total Stockholders' Equity	\$ 38,460	\$ 42,216	\$ 37,432	\$ 29,965	\$ 28,988
<b>SELECTED STATISTICAL DATA:</b>					
Net Interest Margin	3.29%	3.48%	3.82%	3.85%	3.97%
Return on Average Assets	0.29%	0.90%	1.39%	0.64%	(3.10)%
Return on Average Equity	3.19%	8.90%	13.92%	6.33%	(20.02)%
Efficiency Ratio	84.31%	89.30%	86.12%	92.02%	140.39%
<b>RATIOS:</b>					
Net Charge-offs to Average Loans	0.08%	0.01%	–	0.01%	–
Non-performing Loans to Total Loans	0.81%	1.09%	1.03%	1.02%	1.19%
Non-performing Assets to Total Assets	0.51%	0.61%	0.65%	0.68%	0.96%
Allowance for Loan Losses to Total Loans	1.44%	1.84%	1.98%	1.93%	1.70%
Tier 1 Leverage Capital Ratio	9.03%	9.52%	10.80%	9.47%	12.22%
Tier 1 Risk-Based Capital Ratio	12.80%	14.65%	15.36%	13.31%	12.62%
Total Risk-Based Capital Ratio	14.05%	15.90%	16.62%	14.56%	13.87%
<b>OPERATING DATA:</b>					
Net Interest Income	\$ 14,437	\$ 13,428	\$ 12,249	\$ 11,155	\$ 6,532
Provision for Loan Losses	–	\$ 285	–	\$ 772	\$ 2,824
Net Securities (Loss) Gain	\$ (149)	\$ 1,336	\$ 2,119	\$ 1,786	\$ 84
Other Income	\$ 1,047	\$ 605	\$ 511	\$ 516	\$ 383
Other Expense	\$ 13,054	\$ 12,532	\$ 10,989	\$ 10,740	\$ 9,706
Net Income (Loss)	\$ 1,286	\$ 3,624	\$ 4,609	\$ 1,945	\$(5,531)
<b>PER SHARE DATA:</b>					
Diluted Earnings (Loss) Per Share	\$ 0.29	\$ 0.83	\$ 1.09	\$ 0.46	\$ (1.47)
Book Value	\$ 8.78	\$ 9.64	\$ 8.60	\$ 7.11	\$ 6.88

NOTE: Selected financial data and financial highlights for 2013 were derived from the audited consolidated financial statements of Empire Bancorp, Inc. Selected financial data and financial highlights for periods prior to 2013 were derived from the audited financial statements of Empire National Bank.

# DEAR SHAREHOLDER

As we draft this letter we enter our seventh year of operations. Evolution of our Company from its original vision and development finds us at this juncture, which we believe is a time to leverage our shareholders' capital by embracing growth.

Our foundation well equips us to launch into the next phase of our life cycle. Continued delivery of innovative technology permits us to not only meet our customers' needs, but also to compete effectively against larger financial institutions. Changes in bank technology over the past several years, most notably evident in the explosive use of mobile devices, are almost revolutionary. We are proud that we continue expanding our offerings for superior customer convenience and security. Mobile banking, instant debit card replacement, and our "around the clock" customer care service call center are examples of our most recent enhancements.

At Empire National Bank, there is both time and room for conversation with our bankers. We pride ourselves on constantly improving the experiences of our customers, with a staff that offers unparalleled personal service. New customer affiliations are important for our success, and we model these relationships on the trust and mutual support we enjoy with our long-term customers. As seasoned bankers who joined forces from different backgrounds, customer bonds from our past have followed us to Empire National Bank. As a result, many of our customer relationships date back longer than the time our doors have been open. Additionally, changes in our banking community here on Long Island extended opportunities for us to recruit talented and experienced employees to join our team. We have deep confidence in our lineup. Our people are smart and capable, as well as ready and motivated to rise to the challenges along the course of our future.

We became fully taxable for the entire year of 2013, absorbing this tax impact while demonstrating sound financial performance. Free from the regulatory restraints of recent years, coupled with moderate improvement in economic conditions for small businesses in our market area, our year-end loan portfolio increased 20.8% as compared to December 31, 2012. Asset quality and acceptable yields remain our key considerations in the credit decision process. Asset quality remained strong with non-performing assets at 0.51% of total assets at year-end. The volume of loan growth largely supported our rise in net interest income which increased over \$1.0 million or 7.5% for the year ended December 31, 2013 as compared to the year ended December 31, 2012. Also contributing to this increase in net interest income was growth in our average investment securities portfolio of 28.8% year over year. This cautious leveraging of our balance sheet helped drive our earnings to approximately \$1.3 million for 2013. Moving forward, we anticipate upward trends in net income as we continue to grow our balance sheet. The reversal of our tax valuation allowance was completed in 2012, which means that tax expense in 2013 and beyond will be more indicative of the results of our operations.

Sensible management of our risks includes closely monitoring our asset quality and exposure to rising interest rates. During the year, we sold select mortgage-backed securities in an effort to reposition our balance sheet mix for potential market adjustments. As the mix of our loan portfolio is consciously weighted more heavily in commercial real estate, including increased multi-family lending, we maintain a strong focus on due diligence as an integral part of our credit risk management, which includes understanding the different segments of this portfolio as they relate to type and number of units, vacancy rates, underlying real estate values, revenue streams and borrower credit history.



**Douglas C. Manditch**  
Chairman & Chief Executive Officer

Management of the liability side of the balance sheet will be one of our challenges going into the new year. Funding is generally more costly for younger banks, and diversifying our funding sources moderates these pricing and market risks. Our funding mix includes deposits generated through our professional practice expansion, as well as deposits generated both organically and via wholesale markets. Analyzing monetary policy history, the policy shift caused by the Great Recession commencing in December 2008 has led to stagnant short-term interest rates for over sixty months. A tightening phase is inevitable though admittedly difficult to predict. Our asset liability modeling seeks to position our balance sheet in an optimal position to both mitigate these risks and generate improved earnings.

Looking forward, our target is increased shareholder value through growth in core earnings. Recognizing that this growth will largely result from the expansion of our balance sheet, we continue to explore our alternatives to best manage potential capital needs. Our holding company reorganization was approved overwhelmingly by our shareholders at our 2013 annual meeting. The bank holding company is expected to enhance our access to capital resources to support growth. Our new corporate structure also helps facilitate potential acquisitions of related businesses if such opportunities arise. Our ability to diversify our activities and operations is also heightened, allowing us to better compete in the future with other companies in the financial services industry that operate within a holding company structure.

Operationally we are proactively monitoring our efficiency and seeking to control costs, while continuing to evaluate the best ways to expand our franchise. Our decision to open a fourth branch in Mineola during 2013 brings our footprint into Nassau County. We are excited about the opportunities in this market, which align well with our business strategy of serving small to mid-market privately owned businesses, as well as professionals and not-for-profit organizations. Technology makes our growth far less dependent on brick and mortar branches, although we recognize that branch presence remains relevant to certain markets and revenue streams. We continue to set growth goals for each of our branches to help meet our overall business objectives.

No shareholder letter is complete without mentioning the impact of the regulatory burden on community banks. As profit margins of the nation's community banks remain thin, the brunt of complying with new banking regulations is painful medicine to swallow. Regardless of the strength of the balance sheet, the consequences of the costs of financial reforms such as the Dodd-Frank Act are mammoth. As of early February 2014, a total of 398 rules relative to the Dodd-Frank Act had been finalized, which still only represents about fifty percent of the regulations expected to be adopted under the Act. The price of regulatory compliance is staggering and escalates each year. For 2013, other operating expenses attributable to compliance and governance are estimated to exceed \$2.3 million or approximately 13.8% of total revenues. It remains a mystery to us and our colleagues in the community banking business why banks pay their fair share of corporate income taxes while credit unions remain tax-exempt and do not pay one penny in federal and state income tax. Looking at the most recent five-year earnings of the three largest credit unions on Long Island actively competing in our markets revealed cumulative tax-free earnings of over \$440 million dollars. As a career banker largely responsible for chartering two community banks on Long Island, Mr. Manditch is saddened to think the likelihood for future de novo community banks may be grim. Yet, it also



**Thomas M. Buonaiuto**  
President & Chief Operating Officer

# OUR MISSION

To offer the community banking PRODUCTS and SERVICES shaped by EMERGING IDEAS and TECHNOLOGIES, combined with time-honored values of TRUST and INTEGRITY; to provide the highest QUALITY service with a sense of urgency.

provides strong incentive for our success. There are those who may say that we picked the wrong time to start a community bank. We challenge that notion believing that our economy is founded on principles that support competition — competition not only being defined as rivalry amongst existing institutions, but also characterized by a market where entry of new participants is not hindered by nonmarket forces, namely government regulation.

Throughout 2013 we continued our support of numerous not-for-profit organizations that benefit our Long Island community. Our strong commitment to veterans is evidenced by our initiative to propel the fund raising campaign to complete the Wall of Wars memorial at the Veterans Administration Medical Center in Northport. This memorial honors the place where veterans of all ages, spanning decades of wars, come to heal from their physical and psychological wounds. The project was started by The Vietnam Veterans of America Suffolk County Chapter with the hope that the Wall of Wars will become a place to honor and remember our veterans sacrifice along with educating visitors on the history of our country. Our assistance is sometimes financial; yet our personal involvement often provides reinforcement for such groups to recognize their goals. Members of our staff and Board of Directors are generous with their time supporting teens and young mothers at Hope House Ministries; serving as Board members to assist the efforts of organizations, such as Island Harvest, which bridges the gap between those with surplus food and those who need it; working with Child Care Council of Suffolk to ensure quality child care programs for our children; and supporting the Cooley’s Anemia Foundation as they strive for longer and healthier lives for all patients with thalassemia until a universal cure is found. Our employees

are active in the Marcum Workplace Challenge, The Lake Ronkonkoma Run Around the Lake, The Long Island Museum, the Ride for Life and the YMCA, just to name a few. Our broad scope of involvement supports the arts as well as a wide array of educational, health, community and charitable causes. Our corporate culture includes a willingness to serve, helping to improve the quality of life in our market areas.

The success of Empire National Bank to date has been largely determined by the dedication of our staff and also by the ambitions of our Board of Directors. Business referrals play a vital role in the growth of any rising enterprise, including your community bank. As a shareholder, we ask you to please keep us top of mind when discussing banking needs. We principally operate as a small business; therefore we often better understand the fundamentals and challenges of small businesses.

On behalf of our Board of Directors and the entire Empire National Bank team, we thank you for your continued support as a valued shareholder. We look forward to seeing you at our shareholder meeting on May 22, 2014, being held at a new location, the Islandia Marriott Long Island at 3635 Express Drive North in Islandia.

God Bless America!



Douglas C. Manditch  
Chairman and Chief Executive Officer



Thomas M. Buonaiuto  
President and Chief Operating Officer



## FORWARD LOOKING STATEMENTS

This Annual Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and 21E of the Securities Exchange Act of 1934. These forward-looking statements include statements that reflect the current views of our senior management with respect to our financial performance and future events with respect to our business and the banking industry in general. These statements are often, but not always, made through the use of words or phrases such as “may,” “should,” “could,” “predict,” “potential,” “believe,” “will likely result,” “expect,” “will continue,” “anticipate,” “seek,” “estimate,” “intend,” “plan,” “projection,” “would” and “outlook,” and similar expressions of a future or forward-looking nature. These statements involve estimates, assumptions and risks and uncertainties. Accordingly, there are or will be important factors that could cause our actual results to differ materially from those indicated in these statements.

We believe that these factors include, but are not limited to, the following: changes in the strength of the United States economy in general and the local economy in our local market areas adversely affecting our customers and their ability to transact profitable business with us, including the ability of our borrowers to repay their loans according to their terms or a change in the value of the related collateral; changes in interest rates and market prices, which could reduce our net interest margins, asset valuations and expense expectations; changes in the levels of loan prepayments and the resulting effects on the value of our loan portfolio; increased competition for deposits and loans adversely affecting rates and terms; increased credit risk in our assets and increased operating risk caused by a material change in commercial, consumer and/or real estate loans as a percentage of the total loan portfolio; the failure of assumptions underlying the establishment of and provisions made to our allowance for credit losses; changes in the availability of funds resulting in increased costs or reduced liquidity; a determination or downgrade in the credit quality and credit agency ratings of the securities in our securities portfolio; increased asset levels and changes in the composition of assets and the resulting impact on our capital levels and regulatory capital ratios; the loss of senior management or operating personnel and the potential inability to hire qualified personnel at reasonable compensation levels; legislative or regulatory developments, including changes in laws and regulations concerning taxes, banking, securities, insurance and other aspects of the financial securities industry, such as the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), and the extensive rule making required to be undertaken by various regulatory agencies under the Dodd-Frank Act; further government intervention in the U.S. financial system; changes in statutes and government regulations or their interpretations applicable to us, including changes in tax requirements and tax rates; acts of terrorism, an outbreak of hostilities or other international or domestic calamities, weather or other acts of God and other matters beyond our control.

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in this Annual Report. If one or more events related to these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may differ materially from what we anticipate. Accordingly, you should not place undue reliance on any such forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made and we do not undertake any obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for us to predict which will arise. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

*Note: Unless we state otherwise or the context otherwise requires, references in this management’s discussion and analysis to “we,” “our” and “us” refer to Empire Bancorp, Inc. and our consolidated subsidiary.*

## SELECTED HISTORICAL FINANCIAL INFORMATION

The following table sets forth selected historical financial and operating data regarding our organization. As the holding company reorganization was completed on August 22, 2013, the historical financial information for periods prior to 2013 is presented on a bank-only basis, while 2013 information is presented on a consolidated basis. You should review this information together with the discussion that follows and the audited financial statements and related notes included elsewhere in this Annual Report. Average balances have been computed using daily averages, except for average total assets, which are computed using beginning and end of month average balances. Our historical results may not be indicative of our future performance. All dollars are in thousands, except per share data.

	As of and for the year ended December 31,				
	2013	2012	2011	2010	2009
<b>Income Statement Data:</b>					
Interest income .....	\$ 16,216	\$ 15,696	\$ 14,765	\$ 13,999	\$ 8,513
Interest expense .....	1,779	2,268	2,516	2,844	1,981
Net interest income .....	14,437	13,428	12,249	11,155	6,532
Provision for loan losses .....	—	285	—	772	2,824
Net interest income after provision .....	14,437	13,143	12,249	10,383	3,708
Other income .....	898	1,941	2,630	2,302	467
Other expense .....	13,054	12,532	10,989	10,740	9,706
Income before income taxes .....	2,281	2,552	3,890	1,945	(5,531)
Income tax expense (benefit) .....	995	(1,072)	(719)	—	—
Net income .....	<u>\$ 1,286</u>	<u>\$ 3,624</u>	<u>\$ 4,609</u>	<u>\$ 1,945</u>	<u>\$ (5,531)</u>
<b>Period-End Balance Sheet Data:</b>					
Investment securities, available-for-sale .....	\$ 152,639	\$ 180,202	\$ 114,502	\$ 92,696	\$ 33,975
Loans, net of allowance for loan losses .....	290,227	239,211	208,660	214,272	199,737
Allowance for loan losses .....	4,244	4,476	4,216	4,216	3,465
Total assets .....	467,068	438,399	339,733	328,802	251,799
Noninterest-bearing deposits .....	177,252	172,165	45,765	38,024	31,677
Interest-bearing deposits .....	213,679	191,193	219,255	214,166	169,704
Stockholders' equity .....	38,460	42,216	37,432	29,965	28,988
<b>Per Share Data:</b>					
Diluted earnings .....	\$ 0.29	\$ 0.83	\$ 1.09	\$ 0.46	\$ (1.47)
Book value .....	8.78	9.64	8.60	7.11	6.88
Weighted average common shares outstanding .....	4,379,970	4,373,279	4,213,866	4,212,330	3,757,670
<b>Performance Ratios:</b>					
Return on average equity .....	3.19%	8.90%	13.92%	6.33%	(20.02)%
Return on average assets .....	0.29	0.90	0.90	0.64	(3.10)
Net interest margin .....	3.29	3.48	3.82	3.85	3.97
Efficiency ratio(1) .....	84.31	89.30	86.12	92.00	140.40
<b>Asset Quality Ratios:</b>					
Nonperforming assets to total assets(2)(3) .....	0.51%	0.61%	0.65%	0.68%	0.96%
Nonperforming loans to total loans(2)(3) .....	0.81	1.09	1.03	1.02	1.19
Allowance for loan losses to total loans(3) .....	1.44	1.84	1.98	1.93	1.70
Net charge-offs to average loans .....	0.09	0.01	—	0.01	—
<b>Capital Ratios (bank level only):</b>					
Tier 1 leverage capital .....	9.01%	9.52%	10.80%	9.47%	12.22%
Tier 1 risk-based capital .....	12.78	14.65	15.36	13.31	12.62
Total risk-based capital .....	14.03	15.90	16.62	14.56	13.87

(1) Efficiency ratio is the ratio of noninterest expense to net interest income and noninterest income.

(2) For the periods presented, nonperforming assets consist solely of nonperforming loans and nonperforming loans consist solely of nonaccrual loans.

(3) Total loans are net of unearned discounts and deferred fees and costs.

## OUR BUSINESS

### Overview

We are a bank holding company, headquartered in Islandia, New York, which offers a broad range of financial services through our wholly-owned banking subsidiary, Empire National Bank. Our primary market is the counties of Suffolk, Nassau, Kings, Queens and New York in the State of New York which we serve from our main office located at 1707 Veterans Highway, Suite 8, Islandia, New York and from our three branch offices located in Shirley, Port Jefferson Station and Mineola, New York. We believe that our market presents attractive demographic attributes and favorable competitive dynamics, providing long-term growth opportunities for our organization.

We are led by a team of experienced bankers, all of whom have substantial banking experience and relationships on Long Island. We believe that recent changes and disruption within our primary market has created an underserved base of small and medium sized businesses, professionals and other organizations that are interested in banking with a company headquartered in, and with decision-making authority based in, this market. We believe that our management's long-standing presence in the area gives us insight into the local market and, as a result, the ability to tailor our products and services, particularly the structure of our loans, more closely to the needs of our targeted customers. We seek to develop comprehensive, long-term banking relationships by cross-selling loans and core deposits, offering a diverse array of products and services and delivering high quality customer service.

### Our operating strategy

Our business model focuses on a traditional, relationship-based, community bank structure guided by the following principles: disciplined risk management; responsive, high-quality service; focus on building long-term relationships; credibility within our communities; and efficiency. We value our flexible organizational structure and strong risk management culture and believe that the level of market knowledge acquired by our management over their banking careers and customer service differentiates us from other financial institutions. We believe that focusing on these principles will enable us to expand our capabilities for providing value-added services to our customer base and generate steady, long-term growth.

To execute our business model, we have implemented a number of operating strategies, including:

- hiring and retaining qualified banking officers with extensive experience in our market;
- utilizing technology and strategic outsourcing to provide a broad array of secure and convenient products and services in a cost-effective manner;
- developing a suite of focused products and services tailored for professional practice customers in our market;
- operating from highly visible and accessible banking offices in close proximity to a concentration of targeted commercial businesses and professionals;
- expanding our geographic footprint within our primary market through additional branch locations;
- providing individualized attention with consistent, prompt local decision-making authority; and
- leveraging the diverse community involvement, client referrals as well as professional expertise of our organizers, directors and officers.

### Our competitive strengths

We believe that we are well-positioned to create value for our shareholders, particularly as a result of the following competitive strengths:

*Cohesive core management team with extensive local banking experience.* Our senior management team is led by Douglas C. Manditch and Thomas M. Buonaiuto. Mr. Manditch has 48 years of banking experience, all of which have been on and around Long Island, including approximately 24 years as Chief Executive Officer of Long Island-based financial institutions. Mr. Buonaiuto has more than 21 years of banking experience, substantially all of which have been in executive officer capacities of financial institutions in the New York metropolitan area. Each member of our senior management team also has management experience at growing bank franchises, and Messrs. Manditch, Buonaiuto, Hilton (Chief Credit Officer) and Pinna (Chief Technology Officer) have worked together in senior management capacities at other Long Island-based financial institutions. Ms. Verneuille (Chief Financial Officer) served as Executive Vice President and Chief Financial Officer of a bank in organization after spending nearly 15 years at another Long Island-based financial institution, most recently as Executive Vice President and Chief Financial Officer.

*Stable and scalable platform.* Throughout our operating history, we have maintained a stable banking platform with strong capital levels and sound asset quality. At December 31, 2013, the Bank had a 9.01% tier 1 leverage capital ratio, a 12.78% tier 1 risk-based capital ratio and a 14.03% total risk-based capital ratio. Contributing to our stability is our track record of sound asset quality. Utilizing the prior experience of our management team at larger banks operating within our primary market, we believe that we have built a scalable corporate infrastructure, including technology and banking processes, capable of supporting continued growth, while improving operational efficiencies. We believe that our strong capital and asset quality levels will allow us to grow and that our operating platform will allow us to manage that growth effectively, resulting in greater efficiency and improved profitability.

*Growing deposit base.* A significant driver of our franchise is the growth and stability of our deposits, which we use to fund our loans and investment portfolio. At December 31, 2013, our total deposits were \$390.9 million. Our deposit growth has been driven significantly by the growth in our demand deposits, which represented approximately 45.3% of our total deposits at December 31, 2013, up from 15.7% of our total deposits at December 31, 2009. The shift in deposit mix over this period has resulted in lowering the average cost of our deposit liabilities. We seek to cross-sell deposit products at loan origination, which provide a basis for expanding our banking relationships and a stable source of funding.

## **Our challenges**

In implementing our business model, we have faced, and expect to continue to face, a number of challenges that could impact our financial condition, operating results and prospects in future periods, including the following:

- Our business is concentrated in the counties of Suffolk, Nassau, Kings, Queens and New York in the State of New York, and we are more sensitive than our more geographically diversified competitors to adverse changes in the local economy;
- The fair value of our investment securities can fluctuate due to factors outside of our control;
- We face significant competition to attract and retain customers;
- We operate in a highly regulated environment, which could restrain our growth and profitability;
- We depend heavily on our information technology and telecommunications systems, which are subject to systems failures, interruptions and security risks; and
- We may not be able to adequately measure and limit our credit risk, which could impact our profitability.

## **Our market**

Our primary market is the counties of Suffolk, Nassau, Kings, Queens and New York in the State of New York. The economy of our primary market constitutes a diverse cross section of employment sectors, with a mix of services; wholesale/retail trade; federal, state and local government; healthcare; banking and education.

Our primary market is diverse, in terms of educational attainment, income level and ethnic background. According to data provided by the U.S. Census Bureau, the population of Suffolk County was approximately 1,499,273 residents as of July 1, 2012, which represents a 0.4% increase in population since April 1, 2010. Similarly, the population of Nassau County was approximately 1,349,233 residents as of July 1, 2012, which represents a 0.7% increase in population since April 1, 2010. This population growth has attracted many businesses to the area and led to growth in the local service economy, and, while it is not certain, we expect that this trend will continue. In addition, as of 2012, the median household incomes in Suffolk County and Nassau County were \$87,778 and \$97,049, compared to a New York state household income average of \$57,683. Further, according to data provided by the FDIC, between June 30, 2000 and June 30, 2013, FDIC-insured deposits in Suffolk County and Nassau County have increased by approximately 89.8% and 73.1%, respectively. We believe that our market area presents attractive growth opportunities with a diversified and growing customer base. As a community bank, we are focused on serving the needs of the small and medium sized businesses, professionals, nonprofit organizations, and other organizations primarily in Suffolk and Nassau Counties on Long Island, and as well as individual consumers within the communities that we serve.

We compete with a wide range of financial institutions in our market, including local, regional and national commercial banks, thrifts and credit unions. Consolidation activity involving financial institutions based outside of Long Island has altered the competitive landscape in our market within recent years. As of June 30, 2005, approximately 46% of the deposits in Suffolk and Nassau counties were held in banks that were based on Long Island. Based on deposit data as of June 30, 2013 that number had decreased to less than 22% due in large part to the acquisitions of locally-based financial institutions by larger banks based outside of our market area. Although competition within our market area is strong, we believe that the customer disruption associated with these acquisitions, as well as the loss of in-market decision-making and relationship-based banking, will continue to provide us with additional growth opportunities. We also compete with mortgage companies, investment banking firms, brokerage houses, mutual fund managers, investment advisors, and other “non-bank” companies for certain of our products and services. Some of our competitors are not subject to the degree of supervision and regulatory restrictions that we are.

Interest rates, both on loans and deposits, and prices on fee-based services are significant competitive factors among financial institutions generally. Many of our competitors are much larger financial institutions that have greater financial resources than we do and that compete aggressively for market share. These competitors attempt to gain market share through their financial product mix, pricing strategies and banking center locations. Due to the benefits of scale, our larger regional and national bank competitors can, in many cases, offer pricing that is more attractive than that which we can offer, although this pricing has historically been reserved for customers of a size for which we generally would not compete. Other important competitive factors in our market area include office locations and hours, quality of customer service, community reputation, continuity of personnel and services, capacity and willingness to extend credit, and ability to offer sophisticated cash management and other commercial banking services. Many of our competitors are organized along lines of business and use efficient but impersonal approaches to providing products and services to customers.

While we seek to be competitive with respect to rates, we believe that we compete most successfully on the basis of our service and relationship-based culture. Because we are unburdened by legacy main frame computer systems, we believe that our technology platform enables us to be more flexible in developing and implementing new services in a competitive marketplace.

## **Loans**

*General.* Our primary lending focus is to serve small and medium sized businesses, professionals, nonprofit organizations, and other organizations in our primary market with a variety of financial products and services, while maintaining strong and disciplined credit policies and procedures. We offer a full array of commercial and consumer lending products to serve the needs of our customers. Commercial lending products include commercial real estate loans, real estate construction and development loans and general commercial loans (such as business term loans, equipment financing and lines of credit). Consumer lending products include home equity loans and lines of credit and consumer installment loans, such as loans to purchase cars, boats and other recreational vehicles. We do not engage in a material amount of consumer lending, which is offered primarily as an accommodation to our commercial customers, and their executives and employees. In addition, our lending policies do not provide for any loans that are highly speculative, sub-prime, or that have high loan-to-value ratios.

We market our lending products and services to qualified borrowers through conveniently located banking offices, relationship networks and high touch personal service. Our relationship managers actively target long-standing businesses operating in the communities we serve. We seek to attract new lending customers through professional service, relationship networks and competitive pricing.

*Commercial real estate loans.* We offer real estate loans for commercial property that is owner-occupied as well as commercial property owned by real estate investors. Commercial real estate loan terms generally are limited to 20 to 25 years or less, although payments may be structured on a longer amortization basis. The interest rates on our commercial real estate loans may be fixed or adjustable, although rates typically are not fixed for a period exceeding five to ten years. We generally charge an origination fee for our services and require personal guarantees from the principal owners of the business supported by a review of the principal owners' personal financial statements. We make efforts to limit our risks with respect to commercial real estate loans by analyzing borrowers' cash flow and collateral value. The real estate securing our existing commercial real estate loans includes a wide variety of property types, such as offices/warehouses/production facilities, office buildings, hotels, mixed-use residential/commercial, retail centers and multifamily properties.

*Construction loans.* We finance the construction of owner occupied and income producing properties. Construction financing generally requires preapproved permanent financing or pre-sales, unless made on a speculative basis. Construction and development loans are generally made with a term of one to two years and interest is paid monthly. The ratio of the loan principal to the value of the collateral, as established by independent appraisal, typically will not exceed industry standards. Any speculative loans are based on the borrower's financial strength and ability to generate cash flow. Loan proceeds are disbursed based on the percentage of completion and only after the project has been inspected by an experienced construction lender or third-party inspector.

*Commercial loans.* We offer a wide range of commercial loans, including business term loans, equipment financing and lines of credit to small and mid-sized businesses. Our target commercial loan market is retail and professional establishments and small to medium sized businesses. The terms of these loans vary by purpose and by type of underlying collateral, if any. Our commercial loans primarily are underwritten on the basis of the borrower's ability to service the loan from cash flow. We make equipment loans with conservative margins generally for a term of five years or less at fixed or variable rates, with the loan fully amortizing over the term. Loans to support working capital typically have terms not exceeding one year and usually are secured by accounts receivable, inventory and personal guarantees of the principals of the business. For loans secured by accounts receivable or inventory, principal typically is repaid as the assets securing the loan are converted into cash, and for loans secured with other types of collateral, principal is typically due at maturity. The quality of the commercial borrower's management and its ability both to properly evaluate changes in the supply and demand characteristics affecting its markets for products and services and to effectively respond to such changes are significant factors in a commercial borrower's creditworthiness. Although most loans are made on a secured basis, loans may be made on an unsecured basis where warranted by the overall financial condition of the borrower.

*Consumer loans.* We make a variety of loans to individuals for personal purposes, including secured and unsecured installment loans, subordinate mortgages and home equity loans and lines of credit. The amortization of second mortgages generally does not exceed 15 years and the rates generally are not fixed for over 12 months. Consumer loans secured by depreciable assets, such as boats, cars and trailers, are typically amortized over the useful life of the asset. We review the borrower's past credit history, past income level, debt history and, when applicable, cash flow and evaluate the impact of all these factors on the ability of the borrower to make future payments as agreed.

## **Investments**

In addition to loans, we purchase investment securities that are principally either direct debt obligations of the United States Treasury or one of the agencies of the United States government. We may also invest in mortgage backed securities issued by the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Federal Home Loan Bank and the Federal Farm Credit Bureau. Each of these issuer's securities are backed by mortgages conforming to its underwriting guidelines and each issuer guarantees the timely payment of principal and interest on its securities. Our approved policies also allow for investment in both tax exempt and taxable municipal securities, corporate securities and certain equity securities as might be required to deal with various government agencies or banking associations. We regularly

evaluate the composition of this category as changes occur with respect to the interest rate yield curve. Although we may sell investment securities from time to time to take advantage of changes in interest rate spreads, it is our policy not to sell investment securities unless we can reinvest the proceeds at a similar or higher spread, so as not to take gains to the detriment of future income. Overall investment goals are established by the bank's Investment Committee, which reviews the investment portfolio on a periodic basis, and monitors and makes adjustments as necessary based upon current market interest rates and the economic environment, as well as our established policies and strategies. Day-to-day activities pertaining to the investment portfolio are conducted under the supervision of the Bank's President and Chief Operating Officer.

## **Deposits**

Deposits are our primary source of funds to support our earning assets. We offer traditional depository products, including checking, savings, money market and certificates of deposit with a variety of rates. Deposit products are structured to be competitive with rates, fees, and features offered by other local institutions. The primary sources of core deposits are professional practice monies, small to medium sized businesses and their employees, and consumers located within our primary market. We generate deposits through our business development efforts as well as referrals from our existing customers, officers and directors as well as various marketing campaigns. In 2012, we met the requirements established by the United States Trustee for deposits of bankruptcy funds. In addition, we participate in the Certificate of Deposit Account Registry Service ("CDARS®") program, which allows us to accept deposits in excess of the FDIC insurance limits for larger depositors and obtain "pass through" insurance for the total deposit by placing the portion of the deposit in excess of FDIC insurance limits with other FDIC-insured institutions that are members of the CDARS® network.

Our deposit mix has changed substantially over our six year history. At inception, we relied heavily on savings, N.O.W. and money market deposits, as well as certificates of deposit, which require limited customer interaction or convenience in location, while our transactional account customer base and branch networks expanded. We also relied significantly on advances from the Federal Home Loan Bank of New York. Since that time, we have built out a network of four deposit-taking banking offices and attracted significant transaction account business through our relationship-based approach. As of December 31, 2009, the end of our first full calendar year of operations, demand deposits comprised only 15.7% of our total deposits. Since that time, we have shifted the composition of our deposit mix so that demand deposits now comprise our largest source of deposits. As of December 31, 2013, demand deposits comprised 45.3% of our total deposits. The growth in demand deposits has resulted in a lower overall cost of funding for our balance sheet.

## **Supervision and regulation**

We are subject to extensive regulation and supervision that govern almost all aspects of our operations at the holding company and bank levels. We are regulated by the Federal Reserve at the holding company level and by the Office of the Comptroller of the Currency at the bank level. Banking laws, regulations and policies, and the supervisory framework that oversees their administration, are primarily intended to protect consumers, depositors, the Deposit Insurance Fund and the banking system as a whole, and not shareholders and counterparties. In addition, these laws, regulations and policies are subject to continual review by governmental authorities, and changes to these laws, regulations and policies, including changes in their interpretation or implementation, or the adoption of new laws, regulations or policies, can affect us in substantial and unpredictable ways.

In the aftermath of the most recent recession, new legislation has been enacted, and new regulations promulgated, that were designed to strengthen the financial system as a whole. These laws and regulations have imposed significant additional costs on all financial institutions and impacted the banking industry in numerous other ways. A number of the most significant changes in laws and regulations affecting the banking industry are discussed below. However, the discussion that follows is only a brief summary of certain of these laws and regulations, and there are many other laws and regulations that affect our operations, other than those discussed below.

### ***Dodd-Frank Act***

The Dodd-Frank Act, enacted on July 21, 2010, aimed to restore responsibility and accountability to the financial system by significantly altering the regulation of financial institutions and the financial services industry.

The Act, among other things: (i) established the Consumer Financial Protection Bureau, an independent organization within the Federal Reserve dedicated to promulgating and enforcing consumer protection laws applicable to all entities offering consumer financial products or services; (ii) established the Financial Stability Oversight Council, tasked with the authority to identify and monitor institutions and systems that pose a systemic risk to the financial system, and to impose standards regarding capital, leverage, liquidity, risk management, and other requirements for financial firms; (iii) changed the base for FDIC insurance assessments; (iv) increased the minimum reserve ratio for the Deposit Insurance Fund from 1.15% to 1.35%; (v) permanently increased federal deposit insurance coverage from \$100,000 to \$250,000; (vi) directed the Federal Reserve to establish interchange fees for debit cards pursuant to a restrictive “reasonable and proportional cost” per transaction standard; (vii) limited the ability of banking organizations to sponsor or invest in private equity and hedge funds and to engage in proprietary trading; (viii) granted the U.S. government authority to liquidate or take emergency measures with respect to troubled nonbank financial companies that fall outside the existing resolution authority of the FDIC; (ix) increased regulation of asset-backed securities; (x) increased regulation of consumer protections regarding mortgage originations, including originator compensation, minimum repayment standards, and prepayment considerations; and (xi) established new disclosure and other requirements relating to executive compensation and corporate governance.

Some of these provisions have the consequence of increasing our expenses, decreasing our revenues, and changing the activities in which we choose to engage. The specific impact on our current activities or new financial activities that we may consider in the future, our financial performance and the markets in which we operate will depend on the manner in which the relevant agencies develop and implement the required rules and the reaction of market participants to these regulatory developments. Many aspects of the Dodd-Frank Act are subject to rulemaking that will take effect over the next several years, making it difficult to anticipate the overall financial impact on the financial industry, in general, and on us.

### ***Regulatory capital requirements***

On July 2, 2013, the federal banking agencies adopted a final rule revising the regulatory capital framework applicable to all top tier bank holding companies with consolidated assets of \$500 million or more and all banks, regardless of size. The Basel III framework will be applicable beginning January 1, 2015, although the capital conservation buffer, which is discussed in greater detail below, will be phased in over a three-year period, beginning January 1, 2016.

Under the final rule, we will be required to maintain the following minimum regulatory capital ratios:

- A new ratio of common equity tier 1 capital to total risk-weighted assets of not less than 4.5%;
- A tier 1 risk-based capital ratio of 6.0% (an increase from 4.0%);
- A total risk-based capital ratio of 8.0%; and
- A leverage ratio of 4.0%.

The final rule also changes the regulatory capital requirements for purposes of the prompt corrective action regulations. Accordingly, as of January 1, 2015, to be categorized as well capitalized, the bank must have a minimum common equity tier 1 capital ratio of at least 6.5%, a tier 1 risk-based capital ratio of at least 8.0%, a total risk-based capital ratio of at least 10.0%, and a leverage capital ratio of at least 5.0%. The final rule also implements a requirement for all banking organizations to maintain a capital conservation buffer above the minimum capital requirements to avoid certain restrictions on capital distributions and discretionary bonus payments to executive officers. The capital conservation buffer must be composed of common equity tier 1 capital. The capital conservation buffer requirement will effectively require banking organizations to maintain regulatory capital ratios at least 50 basis points higher than well capitalized levels with respect to the risk-weighted capital measures to avoid the restrictions on capital distributions and discretionary bonus payments to executive officers. In addition, the final rule establishes more conservative standards for including an instrument in regulatory capital and imposes certain deductions from and adjustments to the measure of tier 1 capital and tier 2 capital. The final rule alters the method under which banking organizations must calculate risk-weighted assets in an effort to make the calculation of risk-



weighted assets more risk-sensitive, to better account for risk mitigation techniques, and to create substitutes for credit ratings (in accordance with the Dodd-Frank Act).

Although management is continuing to evaluate the impact the final rule will have on our organization, we were in compliance with all applicable minimum regulatory capital requirements as of December 31, 2013 and expect to meet all minimum regulatory capital requirements under the final rule when it becomes effective, as if fully phased in.

The final Basel III framework also requires banks and bank holding companies to measure their liquidity against specific liquidity tests. However, under the proposed rules, the Basel III liquidity framework would apply only to banking organizations with \$250 billion or more in consolidated assets or \$10 billion or more in foreign exposures. As a result, unless modified, the Basel III liquidity framework would not apply to us.

## MANAGEMENT'S DISCUSSION OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis presents management's perspective on our financial condition and results of operations on a consolidated basis. However, because we conduct all of our material business operations through Empire National Bank, the discussion and analysis relates to activities primarily conducted at the subsidiary level. The discussion is intended to highlight and supplement other data and information presented elsewhere in this annual report, including our audited consolidated financial statements and the related notes. Please note that the performance related to the prior periods described in this annual report may not be indicative of our future financial performance.

As a bank holding company that operates through one segment, community banking, we generate most of our revenue from interest on loans and investments, service charges and gains on the sale of investment securities. Our primary source of funding for our loans is deposits, and our largest expenses are interest of these deposits and salaries and related employee benefits. We measure our performance through our net interest margin, return on average assets and return on average equity, while maintaining appropriate regulatory leverage and risk-based capital ratios.

### Performance summary

Our total assets increased \$28.7 million, or 6.5%, to \$467.1 million as of December 31, 2013, compared to \$438.4 million as of December 31, 2012. Our asset growth was largely driven by loan growth of \$50.8 million, or 20.8%, partially offset by a decrease of \$27.6 million in securities available for sale. Asset quality remained strong, with total non-performing loans comprising 0.81% of total loans as of December 31, 2013, compared to 1.09% as of December 31, 2012. Total deposits increased \$27.6 million, or 7.6%, to \$390.9 million as of December 31, 2013, compared to \$363.4 million as of December 31, 2012. Our deposit growth was driven primarily by growth across deposit categories, other than other time deposits, which represent our highest cost of funding. Total stockholders' equity decreased \$3.8 million to \$38.5 million as of December 31, 2013, from \$42.2 million as of December 31, 2012. The decrease in stockholders' equity was primarily attributable to a decrease of \$5.1 million in the value of our securities available for sale, net of applicable taxes, partially offset by our operating earnings.

Net income for the year ended December 31, 2013 was \$1.3 million, compared to net income of \$3.6 million in 2012. The reduction in net income was largely attributable to the impact of sales of investment securities, as well as an increase in income tax expense for the fiscal year ended December 31, 2013 as we became fully taxable. We experienced a decrease of \$1.5 million in net securities gains for the year ended December 31, 2013, as compared to 2012, and an increase in income tax expense of \$2.1 million for the year ended December 31, 2013, as compared to 2012. The decrease in net securities gains and increase in income tax expense were partially offset by an increase of \$1.0 million, or 7.5%, in our net interest income, and an increase of \$442 thousand, or 73.1%, in other income (excluding net securities gains) in 2013, as compared to 2012. Other expenses increased \$522 thousand, or 4.2%, during 2013, as compared to 2012. Net interest margin for the years ended December 31, 2013 and 2012 was 3.29% and 3.48%, respectively, primarily as a result of the continued historically low interest rate environment and market competition, although it was positively impacted by shifts in the mixes of our interest-earning assets and interest-bearing liabilities.

Our efficiency ratio improved to 84.31% for the year ended December 31, 2013, as compared to 89.30% for the year ended December 31, 2012, primarily as a result of our increased operating leverage and an increase in other income. Basic and diluted earnings per share for the year ended December 31, 2013 were \$0.29, compared to \$0.83 in 2012. Our return on average assets was 0.29% for 2013, as compared to 0.90% for 2012, and our return on average equity was 3.19% for 2013, as compared to 8.90% for 2012.

### Comparison of operating results for the years ended December 31, 2013 and 2012

#### *Analysis of net interest income*

Net interest income, the primary contributor to our earnings, represents the difference between the income that we earn on our interest-earning assets and the cost to us of our interest-bearing liabilities. Our net interest income depends upon the volume of interest-earning assets and interest-bearing liabilities and the interest rates that we earn or pay on them.

The following table presents, for the periods indicated, the average balances of our interest-earning assets and interest-bearing liabilities, average yields and costs, and certain other information. Nonaccrual loans are included in loans, and interest on nonaccrual loans is included only to the extent recognized on a cash basis.

	Year Ended December 31,					
	2013			2012		
	Average Balance	Interest Earned/Paid	Average Yield/Cost	Average Balance	Interest Earned/Paid	Average Yield/Cost
	(dollars in thousands)					
Interest earning assets:						
Loans, net (including fee income) ..	\$ 257,718	\$ 12,534	4.86%	\$ 229,821	\$ 12,193	5.31%
Securities available for sale(1).....	176,513	3,526	2.00	137,298	3,343	2.43
Securities, restricted.....	3,497	147	4.20	2,089	123	5.89
Deposits with banks.....	565	5	0.88	15,695	36	0.23
Securities, tax exempt(2) .....	287	7	2.40	—	—	—
Federal funds sold.....	—	—	—	1,024	1	0.10
Total interest-earning assets.....	\$ 438,580	\$ 16,219	3.70	\$ 385,927	\$ 15,696	4.07
Non interest-earning assets:						
Cash and due from banks.....	5,482			9,077		
Other assets.....	7,802			9,765		
Total assets .....	\$ 451,864			\$ 404,769		
Interest bearing liabilities:						
Savings, N.O.W. and money market deposits.....	\$ 139,344	\$ 926	0.66%	\$ 138,353	\$ 1,237	0.89%
Certificates of deposit of						
\$100,000 or more .....	31,756	268	0.84	30,647	279	0.91
Other time deposits.....	32,815	450	1.37	50,356	718	1.43
Borrowed funds .....	35,959	135	0.38	9,203	34	0.37
Total interest-bearing liabilities .....	\$ 239,874	\$ 1,779	0.74	228,559	2,268	0.99
Non interest-bearing liabilities:						
Demand deposits.....	168,561			132,317		
Other liabilities .....	3,134			3,194		
Total liabilities .....	411,569			364,070		
Stockholders' equity .....	40,295			40,699		
Total liabilities and stockholders' equity .....	\$ 451,864			\$ 404,769		
Net interest income .....		\$ 14,440			\$ 13,428	
Net interest spread(3).....			2.96%			3.08%
Net interest margin(4).....			3.29%			3.48%

(1) Unrealized gains / (losses) on securities available for sale are included in other assets.

(2) The above table is presented on a tax equivalent basis.

(3) Net interest spread is the weighted average yield on interest-earning assets minus the weighted average rate on interest-bearing liabilities.

(4) Net interest margin is net interest income divided by average interest-earning assets.

Net interest income increased \$1.0 million for the year ended December 31, 2013, as compared to the prior year. The increase was attributable to growth in total interest income of \$523 thousand and a decrease in total interest expense of \$489 thousand. The growth in total interest income was attributable both to the growth in the average balance of interest-earning assets of \$52.7 million and to the shift in asset mix from investment securities to loans, which represent our highest yielding asset. For the year ended December 31, 2013, average loans represented 58.8% of our average interest-earning assets. The growth in assets, and shift in asset composition, was partially offset by a decrease in the average yield on interest-earning assets resulting from the continued historically low interest rate environment and market competition. The decrease in total interest expense for 2013 was attributable to a reduction in the cost of average interest-bearing liabilities to 0.74% for the year ended December 31, 2013 from 0.99% for the prior year as well as a reduction in the average balance of interest-bearing deposits of \$15.4 million. The decrease in the cost of average interest-bearing liabilities was primarily due to the continued low interest rate environment as well as to reduction in the average balance of time deposits, which represent our highest cost of funding. Average balances of borrowed funds increased by \$26.7 million, which represents our lowest cost of

funding. The increase in net interest income was also positively impacted by an increase of \$36.2 million, or 27.4%, in the average balance of noninterest-bearing demand deposits for the year ended December 31, 2013, as compared to the prior year. Net interest margin for the years ended December 31, 2013 and 2012 was 3.29% and 3.48%, respectively, for the reasons described above.

### **Rate/volume analysis**

The following table analyzes the dollar amount of changes in interest income and interest expense for the primary components of interest-earning assets and interest-bearing liabilities. The table shows the amount of the change in interest income or expense caused by either changes in outstanding balances (volume) or changes in interest rates. The effect of a change in volume is measured by applying the average rate during the first period to the volume change between the two periods. The effect of changes in rate is measured by applying the change in rate between the two periods to the average volume during the first period. Changes attributable to both rate and volume that cannot be segregated have been allocated proportionately to the absolute value of the change due to volume and the change due to rate.

	<b>Year Ended December 31, 2013 Over 2012</b>		
	<b>Increase/(Decrease) Due To</b>		
	<b>Average Volume</b>	<b>Average Rate</b>	<b>Net Change</b>
	(dollars in thousands)		
<b>Interest income on interest-earning assets:</b>			
Loans (including fee income).....	\$ 1,407	\$ (1,066)	\$ 341
Securities available for sale.....	850	(667)	183
Securities, restricted.....	66	(42)	24
Deposits with banks.....	(60)	29	(31)
Securities, tax exempt.....	7	—	7
Federal funds sold.....	(1)	—	(1)
Total increase (decrease) in interest income.....	<u>2,269</u>	<u>(1,746)</u>	<u>523</u>
<b>Interest expense on interest-bearing liabilities:</b>			
Savings, N.O.W. and money market deposits.....	9	(320)	(311)
Certificates of deposit of \$100,000 or more.....	10	(21)	(11)
Other time deposits.....	(241)	(27)	(268)
Borrowed money.....	100	1	101
Total increase (decrease) in interest expense.....	<u>(122)</u>	<u>(367)</u>	<u>(489)</u>
Total increase (decrease) in net interest income.....	<u>\$ 2,391</u>	<u>\$ (1,379)</u>	<u>\$ 1,012</u>

### **Provision for loan losses**

We consider a number of factors in determining the required level of our allowance for loan losses and the provision required to achieve that level, including loan growth, loan quality rating trends, nonperforming loan levels, delinquencies, net charge-offs, industry concentrations and economic trends in our market and throughout the nation. We recorded no provision for loan losses for the year ended December 31, 2013, after recording a \$285 thousand provision for the year ended December 31, 2012. The lack of provision in 2013 reflected management's belief as to the continuing adequacy of the amount of our allowance for loan losses.

### **Other income**

Total other income, which was comprised of customer-related fees and service charges, net securities gains/losses and other operating income, was \$898 thousand and \$1.9 million for the years ended December 31, 2013 and 2012, respectively. The variance in other income over the periods was primarily related to the net security gains that we realized during each of the years, partially offset by the growth of our professional practice revenue. We incurred net securities losses of \$149 thousand for the year ended December 31, 2013, compared to net securities gains of \$1.3 million for the prior year. The net securities losses incurred during 2013 resulted from the disposition of investment securities utilized to fund an increase in loans at a time when market interest rates were increasing. In addition to the increase of \$322 thousand in professional practice revenues, we experienced moderate increases in customer-related fees and service charges, as well as other operating income, which were associated

with the continued growth in our customer base. Miscellaneous service charges and fees include revenues such as electronic funds transfer fees, assignment fees on loans, and wire transfer fees.

### ***Other expense***

Our other expense consists primarily of salary and employee benefits, occupancy and other expenses related to our operation and expansion. Other expense increased by approximately \$522 thousand, or 4.2%, during 2013, as compared to 2012, primarily from expenses associated with our expansion into new markets, products and services. The primary components of the growth in other expense were salaries and benefits, which increased \$332 thousand, or 5.5%, during 2013, primarily due to an increase in employees hired to support our growth. Other operating expenses, increased \$356 thousand or 30.6% for the year ended December 31, 2013, primarily as a result of the payment of fees to our Board of Directors for board and committee meeting attendance totaling \$206 thousand, as well as expenses associated with the expansion of our financial products and services targeted to professional practices. These increases were partially offset by a decrease of \$176 thousand, or 39.2%, in our FDIC insurance expense during 2013, as compared to 2012, largely due to a change in the manner in which FDIC insurance premiums are calculated. As of December 31, 2013 and 2012, we employed 64.5 and 58.9 full time equivalents, respectively. Full time equivalents increased as additional personnel were hired for the branch network, as well as back office operations and lending areas, although assets per employee decreased to \$7.2 million as of December 31, 2013 from \$7.4 million as of December 31, 2012.

### ***Provision for income taxes***

Income tax expense for the year ended December 31, 2013 was \$995 thousand, as compared to an income tax benefit of \$1.1 million for the year ended December 31, 2012. The increase in income tax expense was primarily attributable to the fact that, entering 2012, we had approximately \$2.2 million of net deferred tax assets relating to operating losses incurred in our initial years of operations. Because of improvements in our operating performance, the remainder of the deferred tax assets related to our early stage operating losses were recognized in 2012, resulting in an income tax benefit, which was partially offset by current income tax expense for 2012. Our effective income tax rate for the year ended December 31, 2013, which was 43.6%, more closely reflects the blended federal and state statutory rates for the period.

### ***Financial condition***

Our total assets increased \$28.7 million, or 6.5%, to \$467.1 million as of December 31, 2013, compared to \$438.4 million as of December 31, 2012. Net loans increased \$51.0 million, or 21.3%, to \$290.2 million as of December 31, 2013, compared to \$239.2 million as of December 31, 2012. As a result of management's assessment of the credit quality of the loan portfolio, the allowance for loan losses to total loans was 1.44%, or \$4.2 million, at December 31, 2013 as compared to 1.84%, or \$4.5 million, as of December 31, 2012. Securities available for sale decreased \$27.6 million, or 15.3%, to \$152.6 million as of December 31, 2013, from \$180.2 million as of December 31, 2012. The decrease in securities available for sale was due primarily to dispositions of securities as well as the calls and redemptions on such securities, the proceeds of which were utilized to fund loan growth, but was also affected by a decrease in market value as a result of increasing market interest rates.

Our asset growth for the year ended December 31, 2013 was funded primarily by deposit growth. Total deposits increased \$27.6 million, or 7.6%, to \$390.9 million as of December 31, 2013, compared to \$363.4 million as of December 31, 2012. Our deposit growth was characterized by growth across all deposit categories, other than other time deposits, which represent our highest cost of funding. Demand deposits, which represent a value funding source, increased \$5.1 million, or 3.0%, to \$177.3 million as of December 31, 2013. Savings, N.O.W. and money market deposits increased \$10.1 million, or 7.8%, to \$139.5 million as of December 31, 2013. Certificates of deposit of \$100,000 or more increased \$21.2 million, or 91.2%, to \$44.4 million as of December 31, 2013, while other time deposits decreased by \$8.8 million, or 22.7%, to \$29.8 million as of December 31, 2013. As of December 31, 2013, our loan to deposit ratio was 75.3% as of December 31, 2013, as compared to 67.1% as of December 31, 2012.

Total stockholders' equity decreased \$3.8 million to \$38.5 million as of December 31, 2013, from \$42.2 million as of December 31, 2012. The decrease in stockholders' equity was primarily attributable to a decrease of \$5.1 million in the value of our securities available for sale, partially offset by our operating earnings of \$1.3 million

in 2013. As of December 31, 2013, the Bank was “well capitalized” under applicable regulatory capital guidelines and was in compliance with all applicable regulatory capital standards, with leverage, Tier 1 risk-based and total risk-based capital ratios of 9.01%, 12.78% and 14.03%, respectively.

### Loans

Our primary source of income is interest on loans. Our primary target market is small and medium sized businesses and real estate investors in our market area. Our loan portfolio consists primarily of commercial and industrial loans and real estate loans secured by commercial real estate properties located in our primary area. Our loan portfolio represents the highest yielding component of our earning asset base.

The following table sets forth the amount of loans, by category, as of the respective periods:

	December 31, 2013		December 31, 2012	
	Amount	Percent	Amount	Percent
Commercial real estate mortgages .....	\$ 136,253	46.4%	\$ 119,271	49.0%
Commercial real estate – multi-family .....	98,586	33.5	55,923	22.9
Real estate - construction .....	3,591	1.2	3,312	1.4
Home equity lines of credit .....	3,148	1.1	—	—
Commercial and industrial .....	48,338	16.4	59,925	24.6
Lease financing .....	3,094	1.1	1,334	0.6
Installment/consumer .....	872	0.3	3,729	1.5
Total .....	\$ 293,882	100.0	\$ 243,494	100.0
Net deferred loan costs and (fees) .....	589		193	
Allowance for loan losses .....	(4,244)		(4,476)	
Net loans .....	\$ 290,227		\$ 239,211	

Over the past two years, we have experienced significant growth in our loan portfolio, and our primary focus has been on commercial real estate and commercial lending, which constituted 97.5% of our loan portfolio as of December 31, 2013. Although we expect continued growth with respect to our loan portfolio, we do not expect any significant changes over the foreseeable future in the composition of our loan portfolio or in our emphasis on commercial real estate and commercial lending.

The following table sets forth the contractual maturity ranges, and the amount of loans with fixed and variable rates, in each maturity range as of December 31, 2013:

	Within One Year	After One But Within Five Years	After Five Years	Total
	(dollars in thousands)			
Commercial real estate mortgages .....	\$ 12,076	\$ 3,957	\$ 119,766	\$ 135,799
Commercial real estate – multi-family .....	540	8,698	90,248	99,486
Real estate - construction .....	2,545	—	—	2,545
Home equity lines of credit .....	2,991	—	157	3,148
Commercial and industrial .....	23,812	13,943	11,183	48,938
Lease financing .....	30	3,064	—	3,094
Installment/consumer .....	460	412	—	872
Total .....	\$ 42,454	\$ 30,074	\$ 221,354	\$ 293,882
Rate provisions:				
Amounts with fixed interest rates .....	\$ 7,881	\$ 20,704	\$ 37,761	\$ 66,346
Amounts with variable interest rates .....	34,573	9,370	183,593	227,536
Total .....	\$ 42,454	\$ 30,074	\$ 221,354	\$ 293,882

### ***Nonperforming assets***

Nonperforming assets consist of nonperforming loans, other real estate owned and other repossessed assets. Nonperforming loans consist of loans that are on nonaccrual status, loans past due 90 days or more and still accruing interest, and non-performing restructured loans which are loans on which we have granted a concession on the interest rate or original repayment terms due to financial difficulties with the borrower. Other real estate owned consists of real property that we have acquired through foreclosure. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows discounted at the loan's contractual rate or at the fair value of collateral if repayment is expected solely from collateral. Troubled debt restructurings are accounted for in accordance with FASB ASC 310, "Receivables."

We have maintained low levels of nonperforming assets since our inception in 2008. Our total nonperforming loans comprised 0.81% of total loans as of December 31, 2013, compared to 1.09% as of December 31, 2012. We believe that our historically low level of nonperforming assets reflects our long-term knowledge and relationships with a significant percentage of our borrowers, management's experience and knowledge with respect to our market and our underwriting discipline. Additional information regarding our past due and nonaccrual loans, as well as our troubled debt restructurings, is included in the notes to our consolidated financial statements included in this Annual Report.

### ***Allowance for loan losses***

We maintain an allowance for loan losses that represents management's best estimate of the loan losses and risks inherent in the loan portfolio. In determining the allowance for loan losses, we estimate losses on specific loans, or groups of loans, where the probable loss can be identified and reasonably determined. The balance of the allowance for loan losses is based on internally assigned risk classifications of loans, historical loan loss rates, changes in the nature of the loan portfolio, overall portfolio quality, industry concentrations, delinquency trends, current economic factors and the estimated impact of current economic conditions on certain historical loan loss rates, among other things. The allowance for loan losses is increased by our loan loss provision, which was discussed above, and reduced by net loan charge-offs. Loans are charged-off when we determine that collection has become unlikely. Recoveries are recorded only when cash payments are received. The allowance for loan losses was \$4.2 million, or 1.44% of total loans as of December 31, 2013, compared to \$4.5 million, or 1.84% of total loans, as of December 31, 2012.

We had net charge-offs of \$232 thousand and \$25 thousand for the years ended December 31, 2013 and 2012, respectively. However, historical performance is not necessarily an indicator of future performance, particularly considering our limited operating history. Future results could differ materially. However, management believes, based upon known factors, management's judgment and regulatory methodologies, that the current methodology used to determine the adequacy of the allowance for loan losses is reasonable. An analysis of our allowance for loan losses and net charge-offs is presented in the notes to our consolidated financial statements, which are included in this Annual Report.

The following table sets forth the allocation of the total allowance for loan losses by loan type and sets forth the percentage of loans in each category to gross loans. The allocation of the allowance for loan losses as shown in the table should neither be interpreted as an indication of future charge-offs, nor as an indication that charge-offs in future periods will necessarily occur in these amounts or in the indicated proportions.

	2013		2012	
	Amount	Percentage of Loans to Total Loans	Amount	Percentage of Loans to Total Loans
Commercial real estate mortgages .....	\$ 1,653	39.0%	\$ 2,043	45.6%
Commercial real estate - multi-family...	1,126	26.5	764	17.1
Real estate - construction .....	27	0.7	23	0.5
Home equity lines of credit .....	81	1.9	—	—
Commercial and industrial .....	1,321	31.1	1,606	35.9
Lease financing .....	13	0.3	8	0.2
Installment/consumer .....	23	0.5	32	0.7
Unallocated .....	—	—	—	—
Total .....	<u>\$ 4,244</u>	<u>100.0%</u>	<u>\$ 4,476</u>	<u>100.0%</u>

Although we believe that our allowance for loan losses was adequate to provide for probable incurred losses in our loan portfolio as of December 31, 2013, future provisions will be subject to ongoing evaluations of the risks in our loan portfolio.

### Securities

Our securities portfolio is used to make various term investments, to provide a source of liquidity and to serve as collateral for certain types of deposits and borrowings and to provide interest income. We manage our investment portfolio according to a written investment policy approved by our Board of Directors. Investment balances in our securities portfolio are subject to change over time based on our funding needs and interest rate risk management objectives. Our liquidity levels take into account anticipated future cash flows and all available sources of credits and are maintained at levels management believes are appropriate to assure future flexibility in meeting our anticipated funding needs.

As of December 31, 2013, our securities portfolio consisted primarily of U.S. Government agency obligations and mortgage-backed securities with varying contractual maturities. However, these maturities do not necessarily represent the expected life of the securities as the securities may be called or paid down without penalty. No investment in any of those instruments exceeds any applicable limitation imposed by law or regulation. The Investment Committee reviews the investment portfolio on an ongoing basis in order to ensure that the investments conform to our investment policy as approved by the Board of Directors. As of December 31, 2013, our investment portfolio consisted almost entirely of available for sale securities. As a result, the carrying values of our investment securities are adjusted for unrealized gain or loss as a valuation allowance, and any gain or loss is reported on an after-tax basis as a component of stockholders' equity.

The following table presents a summary of the amortized cost and estimated fair value of our investment portfolio as of the dates presented:

	December 31, 2013		December 31, 2012		December 31, 2011	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
(dollars in thousands)						
Available for sale:						
U.S. government agency securities .....	\$ 28,530	\$ 27,634	\$ 24,975	\$ 25,267	\$ 20,843	\$ 20,976
Mortgage backed securities – residential .....	130,437	125,005	152,531	154,935	92,176	93,526
Total .....	<u>\$ 158,967</u>	<u>\$ 152,639</u>	<u>\$ 177,506</u>	<u>\$ 180,202</u>	<u>\$ 113,019</u>	<u>\$ 114,502</u>
Held to maturity:						
Municipal securities .....	\$ 300	\$ 300	\$ —	\$ —	\$ —	\$ —
Total .....	<u>\$ 300</u>	<u>\$ 300</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

All of our mortgage-backed securities are agency securities. We do not hold any Fannie Mae or Freddie Mac preferred stock, corporate equity, collateralized debt obligations, collateralized loan obligations, structured investment vehicles, private label collateralized mortgage obligations, sub-prime, Alt-A, or second lien elements in



our investment portfolio. At December 31, 2013, our investment portfolio did not contain any securities that are directly backed by subprime or Alt-A mortgages.

The following table sets forth the fair value, amortized cost, maturities and approximated weighted average yield based on estimated annual income divided by the average amortized cost of our securities portfolio at December 31, 2013. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

<b>Available for sale</b>	<b>Amortized Cost</b>	<b>Fair Value</b>	<b>Yield</b>
	(dollars in thousands)		
Due in one year or less .....	\$ —	\$ —	—%
Due from one to five years .....	—	—	—
Due from five to ten years .....	28,530	27,634	1.91
Due after ten years.....	—	—	—
Mortgage backed securities – residential.....	130,437	125,005	2.16
Total.....	<u>\$ 158,967</u>	<u>\$ 152,639</u>	<u>2.11%</u>

<b>Held to maturity:</b>	<b>Amortized Cost</b>	<b>Fair Value</b>	<b>Yield</b>
	(dollars in thousands)		
Due in one year or less .....	\$ 300	\$ 300	1.25%
	<u>\$ 300</u>	<u>\$ 300</u>	<u>1.25%</u>

### **Deposits**

Deposits are our primary source of funds to support our earning assets. Total deposits were \$390.9 million as of December 31, 2013 compared to \$363.4 million as of December 31, 2012. We attribute the growth of our deposit base to a number of factors, including the following:

- Our expanded suite of products and services targeting professional practices;
- The growth of our retail branch network that provides deposit-taking services from four banking locations;
- Our focus on developing and maintaining long-term relationships between our relationship bankers and customers through high quality service; and
- Our commitment to the implementation of technology that enhances customer access to banking products and services.

In addition to our deposit growth, the composition of our deposit base has changed substantially since our inception and over the two-year period ended December 31, 2013. In our initial years of operation, we relied significantly on certificates of deposit, including brokered deposits, due to our limited branch network, deposit pricing and the timing of our funding needs. Since that time, we have expanded our geographic footprint with two additional branch locations and have attracted significant transaction account business through many of the factors described above. The transition has resulted in a more stable core deposit portfolio with a lower overall cost of funds.

The following table shows the growth of our deposit portfolio, and the shift in the composition of our deposits, since December 31, 2011:

	As of December 31,					
	2013		2012		2011	
	Amount	Percent	Amount	Percent	Amount	Percent
	(dollars in thousands)					
Demand deposits.....	\$ 177,252	45.3%	\$ 172,165	47.4%	\$ 45,765	17.3%
Savings, N.O.W. and money market deposits.....	139,524	35.7	129,451	35.6	126,335	47.7
Certificates of deposit of \$100,000 or more .....	44,382	11.4	23,215	6.4	35,006	13.2
Other time deposits.....	29,773	7.6	38,527	10.6	57,914	21.9
Total deposits .....	<u>\$ 390,931</u>	<u>100.0%</u>	<u>\$ 363,358</u>	<u>100.0%</u>	<u>\$ 265,020</u>	<u>100.0%</u>

### **Capital resources**

Total stockholders' equity decreased \$3.8 million to \$38.5 million as of December 31, 2013, from \$42.2 million as of December 31, 2012. The decrease in stockholders' equity during 2013 was primarily attributable to a decrease of \$5.1 million in the value of our securities available for sale during the year, partially offset by our operating earnings of \$1.3 million for the year ended December 31, 2013. Historically, we have not paid cash dividends on our common stock, but instead have retained our earnings to support the continued growth of our organization. We expect to continue this practice for the foreseeable future.

We are subject to various regulatory capital requirements administered by the federal banking agencies. At this time, these regulatory capital requirements apply only at the bank level. As of December 31, 2013, we were in compliance with all applicable regulatory capital requirements, and the Bank was classified as "well capitalized," for purposes of the OCC's prompt corrective action regulations, with leverage, Tier 1 risk-based and total risk-based capital ratios of 9.01%, 12.78% and 14.03%, respectively. "Well capitalized" is the highest capital classification for FDIC-insured financial institutions in the United States. As we employ our capital and continue to grow our operations, our capital levels may decrease depending on our level of earnings. However, we expect to monitor and control our growth in order to remain a "well capitalized" under the applicable regulatory guidelines and in compliance with all regulatory capital standards applicable to us.

## CONSOLIDATED STATEMENTS OF CONDITION

	At December 31,	
	2013	2012
	(dollars in thousands, except share and per share data)	
<b>ASSETS:</b>		
Cash and due from banks.....	\$ 5,486	\$ 4,639
Interest earning deposits with banks.....	480	269
Federal funds sold.....	—	—
Total cash and cash equivalents.....	\$ 5,966	\$ 4,908
Securities available for sale, at fair value.....	152,639	180,202
Securities held to maturity (fair value of \$300 and \$0).....	300	—
Securities, restricted.....	3,450	3,183
Loans.....	294,471	243,687
Less: Allowance for loan losses.....	\$ (4,244)	\$ (4,476)
Loans, net.....	290,227	239,211
Premises and equipment, net.....	6,743	6,412
Accrued interest receivable.....	1,420	1,415
Deferred tax asset.....	5,326	1,695
Other assets.....	997	1,373
<b>Total assets.....</b>	<b>\$ 467,068</b>	<b>\$ 438,399</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Demand deposits.....	\$ 177,252	\$ 172,165
Savings, N.O.W and money market deposits.....	139,524	129,451
Certificates of deposit of \$100,000 or more.....	44,382	23,215
Other time deposits.....	29,773	38,527
Total deposits.....	\$ 390,931	\$ 363,358
Short-term borrowings.....	34,500	30,109
Accrued interest payable.....	114	165
Other liabilities.....	3,063	2,551
<b>Total liabilities.....</b>	428,608	396,183
<b>Stockholders' equity:</b>		
Preferred stock, no par value; Authorized: 30,000 shares; no shares issued or outstanding.....	—	—
Common stock of Empire Bancorp, Inc., par value \$0.01 per share; Authorized: 100,000,000 shares; 4,379,970 issued and outstanding at December 31, 2013 and Common stock of Empire National Bank, par value \$1.00 per share; Authorized: 100,000,000 shares; 4,379,970 issued and outstanding at December 31, 2012.....	44	4,380
Surplus.....	45,061	40,623
Accumulated deficit.....	(3,127)	(4,413)
	41,978	40,590
Accumulated other comprehensive income (loss):		
Net unrealized (losses) gain on securities, net of taxes of \$(2,810) and \$1,070, respectively.....	(3,518)	1,626
<b>Total stockholders' equity.....</b>	<b>38,460</b>	<b>42,216</b>
<b>Total liabilities and stockholders' equity.....</b>	<b>\$ 467,068</b>	<b>\$ 438,399</b>

*See accompanying notes to the Consolidated Financial Statements.*

## CONSOLIDATED STATEMENTS OF OPERATIONS

	<b>Year Ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
	(dollars in thousands, except per share data)	
Interest income:		
Loans (including fee income).....	\$ 12,534	\$ 12,193
Securities available for sale.....	3,526	3,343
Securities, restricted.....	147	123
Securities held to maturity.....	4	—
Deposits with banks.....	5	36
Federal funds sold.....	—	1
Total interest income.....	16,216	15,696
Interest expense:		
Savings, N.O.W and money market deposits.....	926	1,237
Certificates of deposit of \$100,000 or more.....	268	279
Other time deposits.....	450	718
Other borrowed funds.....	135	34
Total interest expense.....	1,779	2,268
Net interest income.....	14,437	13,428
Provision for loan losses.....	—	285
Net interest income after provision for loan losses.....	14,437	13,143
Other income:		
Service charges on deposit accounts.....	432	379
Professional practice revenue.....	322	—
Other service charges and fees.....	293	226
Net securities (losses) gains.....	(149)	1,336
Total other income.....	898	1,941
Other expense:		
Salaries and employee benefits.....	6,341	6,009
Occupancy and equipment, net.....	2,166	2,207
Software services.....	1,424	1,434
Advertising and business development.....	717	776
Professional fees.....	612	492
FDIC insurance.....	273	449
Other operating expenses.....	1,521	1,165
Total other expenses.....	13,054	12,532
Income before income taxes.....	2,281	2,552
Income tax expense (benefit).....	995	(1,072)
Net income.....	\$ 1,286	\$ 3,624
Basic earnings per share.....	\$ 0.29	\$ 0.83
Diluted earnings per share.....	\$ 0.29	\$ 0.83

*See accompanying notes to the Consolidated Financial Statements.*

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	<b>Year Ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
	(in thousands)	
Comprehensive income (loss):		
Net income .....	\$ 1,286	\$ 3,624
Unrealized holding (losses) gains arising during the period .....	(9,173)	2,549
Reclassification adjustment for losses and (gains) included in net income...	149	(1,336)
Change in unrealized net (losses) gains .....	(9,024)	1,213
Tax effect .....	3,880	(480)
Other comprehensive income (loss) .....	(5,144)	733
Total comprehensive income (loss) .....	\$ (3,858)	\$ 4,357

*See accompanying notes to the Consolidated Financial Statements.*

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

	<u>Common Stock</u>			<u>Accumulated Deficit</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total</u>
	<u>Shares Outstanding</u>	<u>Amount</u>	<u>Surplus</u>			
	(dollars in thousands, except shares)					
Balance at January 1, 2012 .....	\$4,352,455	\$ 4,352	\$ 40,224	\$ (8,037)	\$ 893	\$ 37,432
Issuance of common stock.....	27,515	28	193			221
Capitalized offering costs .....			(84)			(84)
Stock based compensation expense			290			290
Total comprehensive income.....				3,624	733	4,357
Balance at December 31, 2012 .....	<u>4,379,970</u>	<u>4,380</u>	<u>40,623</u>	<u>(4,413)</u>	<u>1,626</u>	<u>42,216</u>
Exchange of shares of Empire National Bank, \$1.00 par value, for shares of Empire Bancorp, Inc., \$0.01 par value .....	—	(4,336)	4,336			—
Stock based compensation expense			102			102
Total comprehensive income.....				1,286	(5,144)	(3,858)
Balance at December 31, 2013 .....	<u>4,379,970</u>	<u>\$ 44</u>	<u>\$ 45,061</u>	<u>\$ (3,127)</u>	<u>\$ (3,518)</u>	<u>\$ 38,460</u>

*See accompanying notes to the Consolidated Financial Statements.*

## CONSOLIDATED STATEMENT OF CASH FLOWS

	Year Ended December 31,	
	2013	2012
	(in thousands)	
Operating activities:		
Net income.....	\$ 1,286	\$ 3,624
Adjustment to reconcile net cash provided by operating activities:		
Provision for loan losses .....	—	285
Depreciation and amortization.....	987	1,001
Amortization and accretion.....	1,378	901
Share based compensation expense .....	102	290
Net securities losses (gains).....	149	(1,336)
Increase in accrued interest receivable.....	(5)	(145)
Decrease (increase) in other assets.....	376	(534)
Increase (decrease) in accrued and other liabilities.....	461	(116)
Decrease (increase) in deferred income tax .....	248	(1,953)
<b>Net cash provided by operating activities.....</b>	<b>4,982</b>	<b>2,017</b>
Investing activities:		
Purchases of securities available for sale.....	(27,964)	(144,319)
Sales of securities available for sale .....	19,408	37,729
Calls/redemptions of securities available for sale.....	25,569	42,538
Purchase of securities held to maturity.....	(300)	—
Purchases of securities, restricted .....	(12,633)	(7,372)
Sales of securities, restricted.....	12,366	7,191
Net increase in loans.....	(51,016)	(30,836)
Purchase of banking premises and equipment, net of disposals .....	(1,318)	(563)
<b>Net cash used by investing securities .....</b>	<b>(35,888)</b>	<b>(95,632)</b>
Financing activities:		
Net increase in deposits .....	27,573	98,338
Increase (decrease) in other borrowings .....	4,391	(4,340)
Capitalized offering costs .....	—	(84)
Proceeds from issuance of stock.....	—	221
<b>Net cash provided by financing activities .....</b>	<b>31,964</b>	<b>94,135</b>
Increase in cash and cash equivalents .....	1,058	520
Cash and cash equivalents beginning of period.....	4,908	4,388
<b>Cash and cash equivalents end of period.....</b>	<b>\$ 5,966</b>	<b>\$ 4,908</b>
<b>Supplemental information-cash flows:</b>		
Cash paid for:		
Interest .....	\$ 1,830	\$ 2,412
Income taxes .....	\$ 499	\$ 1,180

*See accompanying notes to the Consolidated Financial Statements.*

**EMPIRE BANCORP, INC**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The consolidated financial statements include the accounts of Empire Bancorp, Inc. (“Bancorp”) and its wholly-owned subsidiary Empire National Bank. Throughout these Notes, “Corporation” refers to Empire Bancorp, Inc. and its consolidated subsidiaries, except as the context otherwise requires, and “Bank” refers only to Empire National Bank.

Bancorp was incorporated on March 22, 2013 for the purpose of becoming a bank holding company for the Bank. The holding company reorganization transaction was effected by means of a statutory share exchange, whereby each share of Bank common stock was exchange for one share of Bancorp common stock. The reorganization transaction became effective on August 22, 2013. As a result, the comparative financial statements as of and for the year ended December 31, 2012 reflect the Bank, on a stand-alone basis.

Because the Bank reflects the sole material asset of the Bancorp, other than cash, the Bancorp’s financial condition and operating results principally reflects those of the Bank. The Bank is a national banking association domiciled in Islandia, New York, which commenced operations on February 25, 2008. The principal business office of Bancorp and Bank is located at 1707 Veterans Highway, Suite 8, Islandia, New York.

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) and to general practices within the financial institution industry. Certain reclassifications have been made to prior year amounts to conform to the current year presentation. The following is a description of the significant accounting policies that the Corporation follows in preparing its financial statements.

a) Use of Estimates

In preparing the financial statements, management has made estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reported periods. Such estimates are subject to change in the future as additional information becomes available or previously existing circumstances are modified. Actual future results could differ significantly from those estimates. The allowance for loan losses and fair value of financial instruments are particularly subject to change.

b) Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks and federal funds sold, which mature overnight. Cash flows are reported net for customer loan and deposit transactions and overnight borrowings.

c) Securities

Current accounting standards require that investment securities be classified as held to maturity, trading or available for sale. Held to maturity securities are where management has a positive intent and ability to hold to maturity, which are to be reported at amortized cost. The trading category is not applicable to any securities in the Corporation’s portfolio because the Corporation does not buy or hold debt or equity securities principally for the purpose of selling in the near term. Available for sale securities, or debt and equity securities which are neither held to maturity securities nor trading securities, are reported at fair value, with unrealized gains and losses, net of the related income tax effect, included in other comprehensive income, a separate component of stockholders’ equity. Restricted securities, as disclosed on the balance sheet consisting of Federal Home Loan Bank stock and Federal Reserve Bank stock, are carried at cost.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method. Prepayments are anticipated for mortgage-backed securities. Realized gains and losses on the sale of securities are determined using the specific identification method.



Declines in the fair value of securities below their cost that are other-than-temporary are reflected as realized losses. In determining other-than-temporary losses, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions and (4) whether the Corporation has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When other-than-temporary loss occurs, management considers whether it intends to sell, or, more likely than not, will be required to sell a security in an unrealized loss position before recovery of its amortized cost basis. If either of these criteria is met, the entire difference between amortized cost and fair value is recognized in earnings. For securities that do not meet the aforementioned criteria, the amount of impairment recognized in earnings is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive income.

d) Federal Home Loan Bank and Federal Reserve Bank Stock

The Bank is a member of and owns stock in the Federal Home Loan Bank of New York (“FHLB of New York”) and the Federal Reserve Bank of New York. The FHLB of New York requires member banks to own a certain amount of stock based on the level of borrowings and other factors, and additional amounts may be invested. Both stocks are carried at cost, classified as restricted securities and periodically evaluated for impairment based on the prospects for the ultimate recovery of par value. Both cash and stock dividends, if any, are reported as income.

e) Loans and Allowance for Loan Losses

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at the principal amount outstanding less any charge offs, net of deferred origination fees and costs, and an allowance for loan losses. Interest on loans is credited to income based on the principal amount outstanding. Loan origination and commitment fees and certain direct and indirect costs incurred in connection with loan originations are deferred and amortized to income over the life of the related loans without anticipating prepayments and as an adjustment to yield. When a loan prepays, the remaining unamortized net deferred origination fees and costs are recognized immediately upon payoff.

Past due status is based on the contractual terms of the loan. Unless a loan is well secured and in the process of collection, the accrual of interest income is discontinued when a loan’s principal or interest payments become ninety days past due. Loans that are deemed uncollectable according to the terms of the loan agreement, or are 90 days past due, are automatically placed on nonaccrual and previously accrued interest is reversed and charged against interest income. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Interest received on nonaccrual loans is accounted for on the cash basis or cost-recovery method until the loans qualify for return to an accrual status. However, if the Corporation believes that the loan will be fully collectible based upon the individual loan evaluation assessing factors such as collateral and collectability, accrued interest will be recognized upon attainment of certain events. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current for a period of time, and future payments are reasonably assured. When the accrual of interest income is discontinued on a loan, any accrued but unpaid interest is reversed against current period income. Unless otherwise noted, the above policy is applied consistently to all loan classes.

The allowance for loan losses is established through provisions for loan losses charged against income. When available information confirms that specific loans or portions thereof, are uncollectible, these amounts are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. Although the allowance for loan losses has two separate components, a specific component for impairment losses on individual loans and a general component for collective impairment losses on pools of loans, the entire allowance for loan losses is available to absorb realized losses as they occur whether they relate to individual loans or pools of loans.

The allowance for loan losses is an amount that management currently believes will be adequate to absorb probable incurred losses in the Corporation’s loan portfolio. The process for estimating credit losses and determining the

allowance for loan losses as of any balance sheet date is subjective in nature and requires material estimates. Actual results could differ significantly from those estimates.

Management currently estimates the general component of the allowance based upon factors including but not limited to an evaluation of inherent risks in the loan portfolio, industry experience, credit risk grades assigned to loans, adverse situations that may affect the borrowers' ability to repay, the estimated value of any underlying collateral, and current economic conditions. Future additions to the allowance may be necessary based on changes in economic conditions or other factors used in management's determination as well as probable incurred losses. In addition, as part of their examination process, regulatory agencies may require additions to the allowance based on their judgments about information available to them.

Estimated losses for loans individually deemed to be impaired are based on either the fair value of collateral, less costs to sell, or the discounted value of expected future cash flows. For all collateral dependent impaired loans, impairment losses are measured based on the fair value of the collateral, less costs to sell. A loan is considered to be impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled principal and interest when due according to the contractual terms of the current loan agreement. Loans that experience minor payment delays and payment shortfall generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due.

Troubled debt restructurings are renegotiated loans for which concessions have been granted to the borrower that the Corporation would not have otherwise granted and the borrower is experiencing financial difficulty. Troubled debt restructurings are separately identified for impairment disclosures. Troubled debt restructurings are by definition impaired loans and are generally reported at the present value of estimated future cash flows using the loan's effective rate at inception. However, if a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported at the loan's observable market price or the fair value of the collateral, less costs to sell. For troubled debt restructurings that subsequently default, the Corporation determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses. Unless otherwise noted, the above policy is applied consistently to all portfolio segments and loan classes.

f) Concentration of Credit Risk

The Corporation's portfolio segments are comprised of commercial real estate loans, commercial real estate – multi-family loans, real estate – construction loans, commercial and industrial loans, lease financing, home equity lines of credit and installment/consumer loans. Risk characteristics of the Corporation's commercial real estate and real estate construction loans tend to be subjective due to vacancy rates, cash flows and the underlying real estate values located in the Corporation's market and primary service area of the counties of Suffolk, Nassau, Kings, Queens and New York. Commercial and industrial and lease financing risk characteristics are driven by economic conditions and the management and capital strength of the borrower.

g) Premises and Equipment

Buildings, furniture and fixtures and equipment are stated at cost less accumulated depreciation. Equipment, computer hardware and software, and furniture and fixtures are depreciated using the straight-line method with a range for useful lives of two to ten years. Leasehold improvements are amortized over the lives of the respective leases, including any option extensions when expected to exercise, or the service lives of the improvements whichever is shorter.

Improvements and major repairs are capitalized, while the cost of ordinary maintenance, repairs and minor improvements is charged to operations.

h) Loan Commitments and Related Financial Instruments

Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer-financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay.

i) Income Taxes

Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using tax rates. Temporary differences are differences between the tax basis of assets and liabilities and their reported amounts in the financial statements that will result in taxable or deductible amounts in future years. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recorded for deferred tax assets if the bank cannot determine that the benefits will more likely than not be realized.

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

j) Earnings per Share

Basic earnings per common share is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted earnings per share, which reflect the potential dilution that could occur if outstanding options and warrants were exercised and resulted in the issuance of common stock that then shared in the earnings of the Corporation, is computed by dividing net income by the weighted average number of common shares and common stock equivalents.

k) Warrants

At December 31, 2013, the Corporation had 365,000 warrants issued and outstanding. The Corporation issued 312,500 warrants to the members of the organizational group in an amount equal to one warrant for each ten dollars advanced during the organizational stage. Additionally, there were 52,500 warrants that were issued to two vendors that during the organizational phase agreed to take warrants in lieu of cash. The warrants are convertible into common shares at an exercise price of ten dollars exercisable through February 24, 2018. The warrants may be subject to exercise or forfeiture in the event that the Corporation’s capital levels have fallen below regulatory minimums (or higher levels as the regulatory agencies may determine). The warrants, in the aggregate, were valued at \$1.1 million and were expensed at the time of issuance in accordance with FASB ASC 718, “*Compensation – Stock Compensation.*” The fair value was determined using the Black-Scholes pricing model.

l) Stock Based Compensation Plans

The Empire National Bank 2008 Stock Incentive Plan provides for the issuance of “incentive stock options” and “nonqualified stock options” to certain qualified individuals. All stock options have a ten-year term and vest at a rate of twenty percent on each of the annual anniversary dates from the date of grant. Each option entitles the holder to purchase one share of the Corporation’s common stock at an exercise price not less than fair market value at the time of issuance. The Corporation will recognize expense for options awarded under the stock incentive plan over the vesting period at the fair market value of the options on the date they were awarded in accordance with FASB ASC 718, “*Compensation – Stock Compensation.*”

m) Comprehensive Income

Comprehensive income includes net income and other comprehensive income. Other comprehensive income includes revenues, expenses, gains and losses that under generally accepted accounting principles are included in comprehensive income but excluded from net income. Comprehensive income and accumulated other comprehensive income are reported net of related income taxes. Accumulated other comprehensive income for the

Corporation includes unrealized holding gains or losses on available for sale securities. Such gains or losses are net of reclassification adjustments for realized gains (losses) on sales of available for sale securities.

n) Fair Value of Financial Instruments

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

o) New Accounting Standards

There were no new accounting standards issued in the current year that had a material impact on the Corporation's financial position, results of operations or disclosures.

p) Subsequent Events

The Corporation has evaluated subsequent events for recognition and disclosure through March 27, 2014, which is the date the financial statements were available to be issued.

## 2. SECURITIES

A summary of the amortized cost, gross unrealized gains, gross unrealized losses and estimated fair value of securities is as follows:

	<b>December 31, 2013</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Estimated Fair Value</b>
	(in thousands)			
Available for sale:				
U.S. government agency securities .....	\$ 28,530	\$ —	\$ (896)	\$ 27,634
Mortgage-backed securities-residential .....	130,437	149	(5,581)	125,005
Total available for sale securities .....	<u>\$ 158,967</u>	<u>\$ 149</u>	<u>\$ (6,477)</u>	<u>\$ 152,639</u>
Held to maturity:				
Tax-exempt municipal debt .....	\$ 300	\$ —	\$ —	\$ 300
Total held to maturity .....	<u>\$ 300</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 300</u>

	<b>December 31, 2012</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Estimated Fair Value</b>
	(in thousands)			
Available for sale:				
U.S. government agency securities .....	\$ 24,975	\$ 292	\$ —	\$ 25,267
Mortgage-backed securities-residential .....	152,531	2,588	(184)	154,935
Total available for sale securities .....	<u>\$ 177,506</u>	<u>\$ 2,880</u>	<u>\$ (184)</u>	<u>\$ 180,202</u>
Held to maturity:				
Tax-exempt municipal debt .....	\$ —	\$ —	\$ —	\$ —
Total held to maturity .....	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

Securities with unrealized losses at December 31, 2013 aggregated by category and length of time that individual securities have been in a continuous unrealized loss position are as follows:

	<b>December 31, 2013</b>			
	<b>Less than 12 months</b>		<b>Greater than 12 months</b>	
	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>
	(in thousands)			
U.S. government agency securities .....	\$ 27,634	(896)	\$ —	\$ —
Mortgage-backed securities-residential .....	69,062	(2,711)	40,511	(2,870)
Total .....	<u>\$ 96,696</u>	<u>\$ (3,607)</u>	<u>\$ 40,511</u>	<u>\$ (2,870)</u>

Unrealized losses on securities have not been recognized into income, as the losses on these securities would be expected to dissipate as they approach their maturity dates. The Corporation evaluates securities for other-than-temporary impairment periodically with increased frequency when economic or market concerns warrant such evaluation. In determining other-than-temporary losses, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions and (4) whether the Corporation has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether another-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time. In analyzing an issuer's financial condition, the Corporation may consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

The fair value of debt securities and carrying amount, if different, at December 31, 2013 by contractual maturity were as follows. Securities not due at a single maturity date, primarily mortgage-backed securities, are shown separately.

	<b>December 31, 2013</b>	
	<b>Available for Sale</b>	
	<b>Amortized</b>	
	<b>Cost</b>	<b>Fair Value</b>
	(in thousands)	
Due in one year or less.....	\$ —	\$ —
Due from one to five years .....	—	—
Due from five to ten years .....	28,530	27,634
Due after ten years .....	—	—
Mortgage-backed securities-residential .....	130,437	125,005
Total .....	<u>\$ 158,967</u>	<u>\$ 152,639</u>
	<b>Held to Maturity</b>	
	<b>Amortized</b>	
	<b>Cost</b>	<b>Fair Value</b>
	(in thousands)	
Due in one year or less.....	\$ 300	\$ 300
Total .....	<u>\$ 300</u>	<u>\$ 300</u>

Proceeds from sales and calls of securities available for sale were \$45.0 million and \$80.3 million for the years ended December 31, 2013 and 2012, respectively. Gross gains of \$34 thousand were realized on the sale of securities during 2013 as compared to gross gains of \$1.3 million in 2012. There were gross losses on the sale of securities in 2013 and 2012 of \$183 and \$0 thousand, respectively.

Securities having a carrying value of approximately \$86.4 million at December 31, 2013 were pledged to public deposits.

### 3. LOANS

The following table sets forth the major classifications of loans:

	December 31,	
	2013	2012
	(in thousands)	
Commercial real estate loans.....	\$ 136,253	\$ 119,271
Commercial real estate – multi-family.....	98,586	55,923
Real estate – construction loans.....	3,591	3,312
Home equity lines of credit.....	3,148	—
Commercial and industrial loans.....	48,338	59,925
Lease financing.....	3,094	1,334
Installment/consumer loans.....	872	3,729
Total.....	<u>\$ 293,882</u>	<u>\$ 243,494</u>
Net deferred loan costs and fees.....	589	193
Allowance for loan losses.....	(4,244)	(4,476)
Net loans.....	<u>\$ 290,227</u>	<u>\$ 239,211</u>

#### Allowance for Loan Losses

An evaluation of the allowance for loan losses is performed on a quarterly basis. To adequately assess the allowance for loan losses the following quantitative and qualitative factors are considered:

##### Quantitative factors:

- Allowance levels and trends for peer banks;
- Delinquency trends of the Corporation and reported delinquency trends for peer banks;
- Historical loss experience of the Corporation over the past four quarters;
- Historical loss experience for peer banks;
- Risk rating migrations; and
- Results of internal and external loan reviews.

##### Qualitative factors:

- Changes in lending policies, procedures, underwriting criteria, as well as collection, charge off and recovery practices;
- Changes in international, national, regional, and local economic and business conditions;
- Changes in portfolio nature and volume;
- Changes in the experience, ability, and depth of lending management and related staff;
- Changes in the volume and severity of past due loans, nonaccrual loans, criticized and classified loans;
- Changes in the quality of the Corporation's loan review system;
- Changes in the value of underlying collateral for collateral-dependent loans;
- Existence and effect of any concentrations of credit and changes in the level of each such concentration;
- Effect of other external factors such as competition and legal and regulatory requirements; and
- Comparison of the Corporation's performance versus that of its peer group.

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment methods as of December 31, 2013 and 2012:

2013	Commercial real estate loans	Commercial real estate-multi family	Real estate-construction loans	Home equity lines of credit	Commercial and industrial loans	Lease financing	Installment/consumer loans	Unallocated	Total
					(in thousands)				
Beginning balance .....	\$ 2,043	\$ 764	\$ 23	\$ —	\$ 1,606	\$ 8	\$ 32	\$ —	\$ 4,476
Provision for loan losses .....	(390)	362	4	81	(53)	5	(9)	—	—
Charge-offs .....	—	—	—	—	(232)	—	—	—	(232)
Recoveries .....	—	—	—	—	—	—	—	—	—
Net charge-off/recoveries .....	—	—	—	—	(232)	—	—	—	(232)
Ending balance .....	<u>\$ 1,653</u>	<u>\$ 1,126</u>	<u>\$ 27</u>	<u>\$ 81</u>	<u>\$ 1,321</u>	<u>\$ 13</u>	<u>\$ 23</u>	<u>\$ —</u>	<u>\$ 4,244</u>
Ending balance: individually evaluated for impairment .....	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 351</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 351</u>
Ending balance: collectively evaluated for impairment .....	<u>\$ 1,653</u>	<u>\$ 1,126</u>	<u>\$ 27</u>	<u>\$ 81</u>	<u>\$ 970</u>	<u>\$ 13</u>	<u>\$ 23</u>	<u>\$ —</u>	<u>\$ 3,893</u>
Loans .....	<u>\$ 136,253</u>	<u>\$ 98,586</u>	<u>\$ 3,591</u>	<u>\$ 3,148</u>	<u>\$ 48,338</u>	<u>\$ 3,094</u>	<u>\$ 872</u>		<u>\$ 293,882</u>
Ending balance: individually evaluated for impairment .....	<u>\$ —</u>	<u>\$ 2,173</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 2,427</u>	<u>\$ —</u>	<u>\$ —</u>		<u>\$ 4,600</u>
Ending balance: collectively evaluated for impairment .....	<u>\$ 136,253</u>	<u>\$ 96,413</u>	<u>\$ 3,591</u>	<u>\$ 3,148</u>	<u>\$ 45,911</u>	<u>\$ 3,094</u>	<u>\$ 872</u>		<u>\$ 289,282</u>

2012	Commercial real estate loans	Commercial real estate-multi family	Real estate-construction loans	Home equity lines of credit	Commercial and industrial loans	Lease financing	Installment/consumer loans	Unallocated	Total
					(in thousands)				
Beginning balance .....	\$ 1,862	\$ 933	\$ 35	\$ —	\$ 1,260	\$ 8	\$ 69	\$ 49	\$ 4,216
Provision for loan losses .....	181	(169)	(12)	—	371	—	(37)	(49)	285
Charge-offs .....	—	—	—	—	(25)	—	—	—	(25)
Recoveries .....	—	—	—	—	—	—	—	—	—
Net charge-off/recoveries .....	—	—	—	—	—	—	—	—	—
Ending balance .....	<u>\$ 2,043</u>	<u>\$ 764</u>	<u>\$ 23</u>	<u>\$ —</u>	<u>\$ 1,606</u>	<u>\$ 8</u>	<u>\$ 32</u>	<u>\$ —</u>	<u>\$ 4,476</u>
Ending balance: individually evaluated for impairment .....	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 435</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 435</u>
Ending balance: collectively evaluated for impairment .....	<u>\$ 2,043</u>	<u>\$ 764</u>	<u>\$ 23</u>	<u>\$ —</u>	<u>\$ 1,171</u>	<u>\$ 8</u>	<u>\$ 32</u>	<u>\$ —</u>	<u>\$ 4,041</u>
Loans .....	<u>\$ 119,271</u>	<u>\$ 55,923</u>	<u>\$ 3,312</u>	<u>\$ —</u>	<u>\$ 59,925</u>	<u>\$ 1,334</u>	<u>\$ 3,729</u>		<u>\$ 243,494</u>
Ending balance: individually evaluated for impairment .....	<u>\$ —</u>	<u>\$ 2,152</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 2,710</u>	<u>\$ —</u>	<u>\$ —</u>		<u>\$ 4,862</u>
Ending balance: collectively evaluated for impairment .....	<u>\$ 119,271</u>	<u>\$ 53,771</u>	<u>\$ 3,312</u>	<u>\$ —</u>	<u>\$ 57,215</u>	<u>\$ 1,334</u>	<u>\$ 3,729</u>		<u>\$ 238,632</u>

### Troubled Debt Restructurings

As of December 31, 2013 and 2012, the Corporation had a recorded investment in troubled debt restructurings of \$4.6 million and \$4.9 million, respectively. The Corporation has allocated \$351 thousand and \$435 thousand of specific reserves for those loans at December 31, 2013 and 2012 and has not committed to lend additional amounts.

Two of the four troubled debt restructured loans totaling \$2.2 million were placed back onto accrual status during 2012 based upon their continued performance.

The modification of the terms of such commercial loans performed during the year ended December 31, 2013 and 2012 included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension

of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; a permanent reduction of the recorded investment in the loan; or a reduction of accrued interest.

There were no troubled debt restructured loans identified during the year ending December 31, 2013. There were no loans modified as troubled debt restructurings that subsequently defaulted within twelve months following the modification.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Corporation's internal underwriting policy.

### Past Due and Nonaccrual Loans

The following table presents the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans as of December 31, 2013 and 2012:

	2013		2012	
	Nonaccrual	Loans Past Due Over 90 Days Still Accruing	Nonaccrual	Loans Past Due Over 90 Days Still Accruing
	(in thousands)			
Commercial real estate loans .....	\$ —	\$ —	\$ —	\$ —
Commercial real estate – multi-family .....	—	—	—	—
Real estate – construction loans .....	—	—	—	—
Home equity lines of credit .....	—	—	—	—
Commercial and industrial loans .....	2,389	—	2,657	—
Lease financing .....	—	—	—	—
Installment/consumer loans .....	—	—	—	—
Total .....	\$ 2,389	\$ —	\$ 2,657	\$ —

The amounts of foregone interest on nonaccrual loans for the years ended December 31, 2013 and December 31, 2012 were \$145 thousand and \$37 thousand, respectively. The Corporation's ratio of nonaccrual loans to total loans was at 0.81% as of December 31, 2013 as compared to a ratio of 1.09% as of December 31, 2012.

No loans were past due greater than thirty days as of December 31, 2013 or 2012.

The Corporation categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Corporation analyzes loans individually by rating the loans based on credit risk. A loan is assigned a risk rating at booking. A risk rating for a loan is reviewed periodically in conjunction with annual credit reviews, external loan review or when one or more events occur such as an event requiring credit approval, changes to an existing credit facility or whenever material favorable or unfavorable information regarding the credit is obtained. The Corporation uses the following definitions for risk ratings:

Pass – Non-criticized and non-classified asset.

Special Mention - A special mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset, or, in the institutions credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. A special mention loan is not a "classified" asset.

Substandard - A substandard asset is inadequately protected by the current creditworthiness and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined



weakness or weaknesses that jeopardize the liquidation of debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

**Doubtful** - An asset classified as doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

**Loss** - An asset classified as loss is considered uncollectible and of such little value that continuance as a bankable asset is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future.

The following tables present risk grades and classified loans by class of loans as of December 31, 2013 and 2012. Classified loans included loans in risk categories of Pass, Special Mention, Substandard, Doubtful and Loss.

		<b>December 31, 2013</b>				
		<b>Pass</b>	<b>Special Mention</b>	<b>Sub- standard</b>	<b>Doubtful</b>	<b>Loss</b>
		(dollars in thousands)				
Commercial real estate loans .....	\$	131,308	\$ 4,945	\$ —	\$ —	\$ —
Commercial real estate – multi-family .....		98,586	—	—	—	—
Real estate – construction loans .....		3,591	—	—	—	—
Home equity lines of credit .....		3,148	—	—	—	—
Commercial and industrial loans .....		43,794	1,156	3,388	—	—
Lease financing .....		3,094	—	—	—	—
Installment/consumer loans .....		872	—	—	—	—
	<b>\$</b>	<b>284,393</b>	<b>\$ 6,101</b>	<b>\$ 3,388</b>	<b>\$ —</b>	<b>\$ —</b>

		<b>December 31, 2012</b>				
		<b>Pass</b>	<b>Special Mention</b>	<b>Sub- standard</b>	<b>Doubtful</b>	<b>Loss</b>
		(dollars in thousands)				
Commercial real estate loans .....	\$	115,068	\$ 2,324	\$ 1,879	\$ —	\$ —
Commercial real estate – multi-family .....		55,923	—	—	—	—
Real estate – construction loans .....		3,312	—	—	—	—
Home equity lines of credit .....		—	—	—	—	—
Commercial and industrial loans .....		55,486	1,782	2,657	—	—
Lease financing .....		1,334	—	—	—	—
Installment/consumer loans .....		3,729	—	—	—	—
	<b>\$</b>	<b>234,852</b>	<b>\$ 4,106</b>	<b>\$ 4,536</b>	<b>\$ —</b>	<b>\$ —</b>

### **Related Party Loans**

Certain directors and their related parties, including their immediate families and companies in which they are principal owners, were loan customers of the Corporation during 2013. The balance of related party loans for years ended December 31, 2013 and December 31, 2012 were \$1.5 million and \$742 thousand respectively.

#### 4. PREMISES AND EQUIPMENT

Premises and equipment consist of:

	December 31,	
	2013	2012
	(in thousands)	
Furniture and fixtures .....	\$ 5,884	\$ 5,118
Leasehold improvements.....	6,032	5,480
	11,916	10,598
Less: accumulated depreciation and amortization .....	(5,173)	(4,186)
	<u>\$ 6,743</u>	<u>\$ 6,412</u>

#### 5. DEPOSITS

##### Time Deposits

The following table sets for the remaining maturities of the Corporation's time deposits at December 31, 2013:

	Less than \$100,000	\$100,000 or Greater	Total
	(in thousands)		
2014.....	\$ 15,044	\$ 21,211	\$ 36,255
2015.....	11,387	13,832	25,219
2016.....	2,108	8,086	10,194
2017.....	705	858	1,563
2018.....	529	—	529
Thereafter .....	—	395	395
	<u>\$ 29,773</u>	<u>\$ 44,382</u>	<u>\$ 74,155</u>

The total amount of brokered deposits at December 31, 2013 and 2012 were \$17.5 million and \$22.5 million, respectively.

#### 6. SHORT-TERM BORROWINGS

At December 31, 2013, the Corporation had \$34.5 million of short-term borrowings outstanding with the Federal Home Loan Bank at a rate of 0.40% with a maturity date of January 2, 2014. As of December 31, 2013 the Federal Home Loan Bank held \$148.2 million of loans and \$13.3 million of securities available for sale in collateral.

#### 7. INCOME TAXES

Income tax expense (benefit) was as follows:

	For the years ended December 31,	
	2013	2012
	(in thousands)	
Current:		
Federal.....	\$ 973	\$ 668
State.....	(195)	213
	778	881
Deferred:		
Federal.....	271	188
State.....	(54)	26
	217	214
Change in valuation allowance.....	—	(2,167)
Total .....	<u>\$ 995</u>	<u>\$ (1,072)</u>

The reconciliation of the expected Federal income tax expense at the statutory tax rate to the actual provision follows:

	<b>For the years ended December 31,</b>			
	<b>2013</b>		<b>2012</b>	
	<b>Amount</b>	<b>Percentage of Pre-tax Earnings</b>	<b>Amount</b>	<b>Percentage of Pre-tax Earnings</b>
	(dollars in thousands)			
Federal income tax benefit computed by applying the statutory rate to income before income taxes.....	\$ 776	34%	\$ 868	34%
State tax, net of federal .....	143	6	157	6
Incentive stock options .....	28	1	59	2
Other .....	48	3	11	1
Valuation allowance .....	—	—	(2,167)	(85)
Provisions for income taxes .....	<u>\$ 995</u>	<u>44%</u>	<u>\$ (1,072)</u>	<u>(42)%</u>

Deferred tax assets and liabilities are comprised of the following:

	<b>For the year ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
	(in thousands)	
<b>Deferred tax assets:</b>		
Allowance for loan losses .....	\$ 1,520	\$ 1,520
Organizational and start-up costs .....	610	668
Nonqualified stock options .....	229	222
Deferred rent expense .....	624	627
Nonaccrual loan interest income .....	72	21
Other .....	98	4
Net unrealized loss on available for sale securities .....	2,810	—
	<u>\$ 5,963</u>	<u>\$ 3,062</u>
<b>Deferred tax liabilities:</b>		
Net deferred loan costs .....	\$ (234)	(76)
Depreciation .....	(369)	(221)
Other .....	(34)	—
Net unrealized gain on securities .....	—	(1,070)
	<u>(637)</u>	<u>(1,367)</u>
Net deferred tax asset .....	<u>\$ 5,326</u>	<u>\$ 1,695</u>

Prior to 2012 the Bank's net deferred tax assets were subject to a valuation allowance because the Bank had been unable to conclude that realization of the deferred tax assets was more likely than not. In light of the Bank's improved performance, in 2012 the Bank concluded that it was more likely than not that it would continue to generate taxable income in future years and that all of the deferred tax assets would be realized. Accordingly, the Bank reversed the remaining valuation allowance in 2012, which resulted in a credit to earnings, offset by the current income tax expense for the year. As a result of the recognition of the remaining net operating loss carryovers in 2012, the Bank's effective income tax rate for the period subsequent to 2012 more closely reflects its blended federal and state income tax rates.

At December 31, 2013 and December 31, 2012, the Corporation had no unrecognized tax benefits. The Corporation does not expect the amount of the unrecognized tax benefits to significantly change within the next twelve months.

The Corporation is subject to U.S. federal and New York State income tax. The tax years 2010-2012 remain open to examination by the Internal Revenue Service. Currently New York State is examining the Bank's 2010-2012 New York State tax returns; no significant adjustments to the tax liability are expected to result from this exam.

## 8. EMPLOYEE BENEFITS

### 401(K) Plan

A savings plan is maintained under Section 401(k) of the Internal Revenue Code and covers substantially all current employees. Newly hired employees can elect to participate in the savings plan after completing one year and 1,000 hours of service. Under the provisions of the savings plan, employee contributions are partially matched by the Corporation with cash contributions. Participants can invest their account balances into several investment alternatives. The savings plan does not allow for investment in the Bancorp's common stock. During the years ended December 31, 2013 and 2012, the Corporation recorded compensation expense related to the plan of approximately \$209 thousand and \$160 thousand, respectively.

### Equity Incentive Plan

The Empire National Bank 2008 Stock Incentive Plan ("Plan") authorizes the issuance to qualified individuals of 600,000 stock options. All stock options and warrants issued by the Bank prior to the holding company reorganization transaction were converted into Bancorp stock options as of the effective date of the reorganization. At December 31, 2013, options to purchase 84,750 shares of common stock remained available for issuance under the Plan. During the year ended December 31, 2013, the Corporation did not grant any stock options or warrants.

The Board of Directors determines options awarded under the Plan. The Corporation accounts for this Plan under FAS ASC 718, "Compensation – Stock Compensation."

The fair value of each option granted is estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for the following years:

	<b>For the year ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
Risk free interest rate.....	—	1.70%
Expected dividend yield.....	—	0.00%
Expected volatility.....	—	52.82%

Information related to the stock option plan follows.

	<b>2013</b>	<b>2012</b>
Weighted average fair value of options granted.....	\$ —	\$ 3.41

A summary of activity related to the Corporation's stock options as of December 31, 2013 follows:

	<b>Number of Options</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Life</b>
Outstanding, beginning of year.....	515,250	\$ 10.00	
Granted.....	—	\$ 10.00	
Exercised.....	—	—	
Forfeited.....	—	\$ 10.00	
Outstanding, end of year.....	<u>515,250</u>	\$ 10.00	4.81 years
Exercisable, end of year.....	451,450	\$ 10.00	4.33 years
Vested or expected to vest.....	515,250	\$ 10.00	4.81 years
	<b>Number of Shares</b>	<b>Price</b>	
Range of exercise prices.....	<u>515,250</u>	\$ 10.00	

All options vest ratably over five years beginning one year from the date of grant and have a ten year duration. Compensation expense attributable to these options was \$102 thousand and \$290 thousand for the years ended

December 31, 2013 and 2012, respectively. As of December 31, 2013, there was \$193 thousand of total unrecognized compensation costs related to nonvested stock options granted under the Plan.

## 9. EARNINGS PER SHARE

The following is a reconciliation of earnings per share for December 31, 2013 and 2012:

	<b>For the years ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
	(in thousands, except per share data)	
Net income.....	\$ 1,286	\$ 3,624
Common equivalent shares:		
Weighted average common shares outstanding .....	4,380	4,373
Weighted average common equivalent shares .....	—	—
Weighted average common and common equivalent shares.....	4,380	4,373
Basic earnings per share.....	\$ 0.29	\$ 0.83
Diluted earnings per share.....	\$ 0.29	\$ 0.83

There are approximately 515,250 options and 365,000 warrants outstanding at December 31, 2013 and 2012 that were not included in the computation of diluted earnings per share because the exercise prices were greater than the average market price of common stock and were, therefore, antidilutive.

## 10. COMMITMENTS AND CONTINGENCIES AND OTHER MATTERS

In the normal course of business, there are various outstanding commitments and contingent liabilities, such as claims and legal actions, minimum annual rental payments under non-cancelable operating leases, guarantees and commitments to extend credit, which are not reflected in Corporation's financial statements. No material losses are anticipated as a result of these actions or claims.

### Leases

The Corporation is obligated to make minimum annual rental payments under non-cancelable operating leases on its premises. Projected minimum rentals under existing leases are as follows:

	<b>December 31, 2013</b>
	(in thousands)
2014.....	\$ 782
2015.....	770
2016.....	794
2017.....	820
2018.....	844
Thereafter.....	9,023

Certain leases contain renewal options and rent escalation clauses. In addition, certain leases provide for additional payments based upon real estate taxes, interest and other charges. Rental expenses under these leases for the years ended December 31, 2013 and 2012 approximated \$676 thousand and \$705 thousand, respectively. The above chart includes the minimum annual rental payments through lease renewal periods based upon management's intentions to execute the renewal options.

### Loan Commitments

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance-sheet risk to credit loss exists up to the face amount of these instruments,

although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, often including obtaining collateral at exercise of the commitment.

The following represents commitments outstanding:

	December 31,			
	2013		2012	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
	(in thousands)			
Standby letters of credit.....	\$ 683	\$ 72	\$ 508	\$ 72
Commercial letters of credit.....	—	—	20	—
Unused loan commitments.....	1,171	46,516	409	35,311
Commitments to make loans.....	350	22,290	1,527	7,527
Total commitments outstanding.....	<u>\$ 2,204</u>	<u>\$ 68,878</u>	<u>\$ 2,464</u>	<u>\$ 42,910</u>

## Other

During 2013, the Bank maintained an overnight line of credit with the Federal Home Loan Bank of New York. The Bank has the ability to borrow against its unencumbered mortgages and investment securities owned by the Bank.

As a member of the Federal Reserve Bank, the Bank may borrow on a collateralized basis at the discount window. There were no borrowings from the discount window at December 31, 2013.

At December 31, 2013, the Bank had aggregate lines of credit of \$23 million with unaffiliated correspondent banks to provide short-term credit for liquidity requirements. Of these aggregate lines of credit, \$19 million is available on an unsecured basis. As of December 31, 2013, the Bank had no such borrowings outstanding.

## 11. ESTIMATED FAIR VALUE MEASUREMENTS

FAS ASC, “Fair Value Measurements and Disclosures,” establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity’s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used to in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities’ relationship to other benchmark quoted securities (Level 2 inputs).

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

	Fair Value Measurements at December 31, 2013 using:		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:	(in thousands)		
U.S. government agency securities.....	\$ —	\$ 27,634	\$ —
Mortgage-backed securities-residential.....	\$ —	\$ 125,005	\$ —

Fair Value Measurements at December 31, 2012 using:			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:		(in thousands)	
U.S. government agency securities.....	\$ —	\$ 25,267	\$ —
Mortgage-backed securities-residential.....	\$ —	\$ 154,935	\$ —

At December 31, 2013, there were no impaired loans carried at fair value.

As of December 31, 2013 and 2012, the carrying amounts and estimated fair values of financial instruments, not previously presented, were as follows:

	December 31, 2013	
	Carrying Amount	Fair Value
<b>Financial assets:</b>		
Cash and cash equivalents .....	\$ 5,966	\$ 5,966
Securities, held to maturity .....	300	300
Securities, restricted .....	3,450	n/a
Loans, net .....	294,471	295,476
Accrued interest receivable.....	1,420	1,420
<b>Financial liabilities:</b>		
Demand, savings, N.O.W. and money market deposits.....	\$ 316,776	\$ 316,776
Certificates of deposit of \$100,000 or more and other time deposits.....	74,155	74,221
Short-term borrowings.....	34,500	34,500
Accrued interest payable .....	114	114
<b>December 31, 2012</b>		
	Carrying Amount	Fair Value
<b>Financial assets:</b>		
Cash and cash equivalents .....	\$ 4,908	\$ 4,908
Securities, restricted .....	3,183	n/a
Loans, net .....	243,687	249,686
Accrued interest receivable.....	1,415	1,415
<b>Financial liabilities:</b>		
Demand, savings, N.O.W. and money market deposits.....	\$ 301,616	\$ 301,616
Certificates of deposit of \$100,000 or more and other time deposits.....	61,742	62,300
Short-term borrowings.....	30,109	30,109
Accrued interest payable .....	165	165

The carrying amounts of cash and cash equivalents approximate fair values and are classified as Level 1. The fair values of securities held to maturity are determined in the same manner as securities available for sale disclosed earlier in this note. It is not practical to determine the fair value of restricted securities due to restrictions placed on its transferability. The fair value of loans is computed by calculating the new present value of estimated future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the remaining maturities and terms, resulting in a Level 3 classification. The fair values disclosed for demand, savings, N.O.W. and money market deposits are, by definition, equal to the amount payable on demand at the reporting date resulting in Level 1 classification. The fair value for certificates of deposit is computed by calculating the net present value of estimated future cash flows, using the current rates at which similar certificates of deposit would be issued to depositors, resulting in a Level 2 classification. The short term borrowings generally maturing within 90 days approximate their fair values resulting in a Level 2 classification. For accrued interest receivable and payable, the recorded book value is a reasonable estimate of fair value and the fair value level follows the underlying contract.

## 12. REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can result in certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation's financial statements.

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the its assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. The Bank's capital amounts and classification also are subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital to risk weighted assets, and of Tier 1 capital to average assets, as those terms are defined in applicable OCC regulations.

As of December 31, 2013, the Bank was classified as "well capitalized," for purposes of the OCC's prompt corrective action regulations. "Well capitalized" is the highest capital classification for FDIC-insured financial institutions in the United States. To be categorized as "well capitalized," the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table below. Management believes, as of December 31, 2013, that the Bank met all capital adequacy requirements.

The Bank's actual capital amounts and ratios are presented in the following table:

As of December 31,	2013					
	Actual		To be Adequately Capitalized Under Prompt Corrective Action Provisions		To be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(dollars in thousands)					
Total risk-based capital ratio .....	\$ 46,001	14.03%	\$ 26,228	>8.00%	\$ 32,785	>10.00%
Tier 1 risk-based capital ratio .....	41,901	12.78%	13,114	>4.00%	19,671	>6.00%
Tier 1 leverage ratio .....	41,901	9.01%	18,611	>4.00%	23,264	>5.00%
	2012					
	(dollars in thousands)					
Total risk-based capital ratio .....	\$ 44,067	15.90%	\$ 22,172	>8.00%	\$ 27,715	>10.00%
Tier 1 risk-based capital ratio .....	40,590	14.65%	11,086	>4.00%	16,629	>6.00%
Tier 1 leverage ratio .....	40,590	9.52%	17,062	>4.00%	21,328	>5.00%



## INDEPENDENT AUDITOR'S REPORT

Board of Directors and Stockholders  
Empire Bancorp, Inc.  
Islandia, New York

**Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of Empire Bancorp, Inc., which comprise the consolidated statements of condition as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

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

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

***Auditor's Responsibility***

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

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

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

***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Empire Bancorp, Inc. as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Crowe Horwath LLP*

Crowe Horwath LLP

New York, New York  
March 27, 2014

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## BOARD OF DIRECTORS\*

**Douglas C. Manditch**  
Chairman of the Board & Chief Executive Officer  
*Empire National Bank*

**Thomas M. Buonaiuto, CPA**  
President & Chief Operating Officer  
*Empire National Bank*

**John P. Bracken, Esq.**  
Organizer & Vice Chairman of the Board  
*Managing Partner, Bracken Margolin Besunder, LLP*



**Francis F. Boulton**  
Organizer & Director  
*CEO, Long Island Ducks Professional Baseball Club, LLC*

**John D. Caffrey, Jr.**  
Organizer & Director  
*Owner, Castle Financial Advisors, LLC & Castle Asset Management, LLC*

**John L. Ciarelli, Esq.**  
Organizer & Director  
*President, Ciarelli & Dempsey P.C.*



**Dr. Alan M. Coren**  
Organizer & Director  
*President, West Hills Animal Hospital P.C.*

**Larry R. Davis, Esq.**  
Organizer & Director  
*Principal, Davis & Prager, P.C.*

**Frank A. DiFazio**  
Organizer & Director  
*President, Dekal Services, Inc.*



**Salvatore Ferro**  
Organizer & Director  
*President & CEO, Alure Home Improvements, Alure Basements & Alure Designs*

**Mukeshkumar Patel**  
Organizer & Director  
*President, Shirley Motel, Inc.*

**Charles C. Russo, Esq.**  
Organizer & Director  
*Senior Partner, Russo Karl Widmaier & Cordano, PLLC*



**Joseph S. Tantillo, Jr.**  
Organizer & Director  
*Founder & CEO, Nassau Suffolk Electrical & Mechanical*

**Paul J. Tonna**  
Organizer & Director  
*Molloy College's Executive Director for the Energiea Partnership*

**Jeffrey M. Weiner**  
Organizer & Director  
*Managing Partner, Marcum, LLP*

Not Pictured: Dr. Robert J. Frey, Director,  
*Research Professor; Director of the Program in Quantitative Finance in the Dept. of Applied Mathematics & Statistics, Stony Brook University*

\*Each director serves on the Boards of Empire National Bank and Empire Bancorp, Inc.

# OFFICERS

## EMPIRE BANCORP, INC. EXECUTIVE OFFICERS

**Douglas C. Manditch**  
Chairman of the Board,  
Chief Executive Officer & Secretary

**John P. Bracken, Esq.**  
Vice Chairman of the Board

**Thomas M. Buonaiuto, CPA**  
President, Chief Operating Officer &  
Assistant Secretary

**Christopher J. Hilton**  
Vice President

**John Pinna**  
Vice President

**Janet T. Verneuille, CPA**  
Vice President & Chief Financial Officer

**Diane L. Murray, CPA**  
Assistant Secretary

## EMPIRE NATIONAL BANK EXECUTIVE OFFICERS

**Douglas C. Manditch**  
Chairman of the Board &  
Chief Executive Officer

**Thomas M. Buonaiuto, CPA**  
President & Chief Operating Officer

**Christopher J. Hilton**  
Executive Vice President &  
Chief Credit Officer

**John Pinna**  
Executive Vice President &  
Chief Information Officer

**Janet T. Verneuille, CPA**  
Executive Vice President &  
Chief Financial Officer

## SENIOR VICE PRESIDENTS

**Diane L. Murray, CPA**  
Chief Risk Officer &  
Deputy Compliance BSA Officer

**Michael J. Spolarich**  
Senior Lending Officer

## VICE PRESIDENTS

**Danielle DiGrazia**  
Operations Officer

**Erminio Fiore**  
Business Development Officer

**William T. Franz**  
Director of Marketing & Investor  
Relations

**Catherine Giamundo, CPA**  
Controller

**Craig Goldstein**  
Commercial Loan Officer

**Erik Griemsmann**  
IT Manager

**William Guiducci**  
Branch Manager  
*Shirley*

**Daniel G. Lehan**  
Commercial Loan Officer

**Edy Meyer**  
Branch Manager  
*Port Jefferson Station*

**Richard A. Miceli**  
Loan Administration

**Dorothy Overton**  
Branch Manager  
*Islandia*

**Raffaella Palazzo**  
Credit Administration

**Jane Reid**  
Human Resources

**Matthew Ruppert**  
Portfolio Manager

**Mannie Singh**  
Commercial Loan Officer

**Marguerite Smith**  
BSA & Compliance Officer

**Michael R. Soffer**  
Commercial Loan Officer

**John P. Solensky**  
Commercial Loan Officer

**Daniel J. Viola**  
Director of Information Technology

## ASSISTANT VICE PRESIDENTS

**Krista M. Braccia**  
Branch Manager  
*Mineola*

**Jeanne M. Dahl**  
Assistant Branch Manager  
*Port Jefferson Station*

**Miranda M. D'Angelis**  
Staff Accountant

**Joseph A. DeVenuti**  
Electronic Banking Officer

**Margaret Downing**  
Assistant Branch Manager  
*Shirley*

**Jessica M. Michalski**  
Staff Accountant

**Steven Post**  
Electronic Banking Manager

**Janet Weissman**  
Assistant Branch Manager  
*Islandia*

**Deborah McCullough**  
Assistant Branch Manager  
*Mineola*

## MANAGERS

### Assistant Branch Managers

**Suzanne Fox**  
Assistant Branch Manager  
*Islandia*

**Theresa Naumann**  
Assistant Branch Manager  
*Shirley*

**Michael Wilk**  
Assistant Branch Manager  
*Islandia*

## LEGAL COUNSEL

**Geoffrey Scot Kay**  
Fenimore, Kay, Harrison & Ford, LLP  
Austin, TX

## INDEPENDENT REGISTERED PUBLIC ACCOUNTANTS

**Crowe Horwath LLP**  
New York, NY

## TRANSFER AGENT

**Broadridge Corporate Issuer  
Solutions, Inc.**  
Philadelphia, PA  
(877) 830-4936



*EXECUTIVE OFFICERS: Janet T. Verneuille; Douglas C. Manditch; Diane L. Murray; Christopher J. Hilton; Michael J. Spolarich; Thomas M. Buonaiuto; John Pinna*



## ISLANDIA, Headquarters

*1707 Veterans Highway, Suite 8  
Islandia, NY 11749  
631-348-4444*





## MINEOLA

170 Old Country Road  
Mineola, NY 11501  
516-741-0444



## PORT JEFFERSON STATION

4747 Nesconset Highway, Unit 36  
Port Jefferson Station, NY 11776  
631-928-4444



## SHIRLEY

1044 William Floyd Parkway  
Shirley, NY 11967  
631-395-9500

## INVESTOR INFORMATION

Empire Bancorp, Inc. is a registered bank holding company for Empire National Bank. Empire Bancorp, Inc.'s common stock is listed on the OTCQB marketplace under the symbol "EMPK." Empire National Bank is a Long Island-based independent bank that specializes in serving the financial needs of small and medium-sized businesses, professionals, nonprofit organizations, real estate investors, and consumers. The bank has four banking offices located in Islandia, Shirley, Port Jefferson Station, and Mineola. The bank takes pride in understanding the needs of each and every customer so that it can deliver the highest quality service with a sense of urgency.

Additional copies of Empire Bancorp, Inc.'s Annual Report can be obtained in PDF form from the Bank's website [www.empirenb.com](http://www.empirenb.com) in the Investor Relations section.

# SUPPORTING OUR COMMUNITY

We are well aware that a large part of our SUCCESS is tied to the STRENGTH of the local economy. As a community bank, we embrace our position within each community and look to facilitate helping businesses and individuals grow and prosper.

Our COMMITMENT TO COMMUNITY is in everyone's best interest. We are proud to work with so many important, LOCAL ORGANIZATIONS.

Association for Children with Down Syndrome

Advancement for Commerce Industry and Technology

Association for the Help of Retarded Children

American Heart Association

Angela's House

Arthritis Foundation

Association for Corporate Growth

Autism Speaks

Boy Scouts of America

Boys & Girls Club of Suffolk County

Brookhaven Children & Youth Services

Central Nassau Guidance & Counseling

Child Care Council of Nassau

Child Care Council of Suffolk, Inc.

Children's Sports Connections

Christmas Magic, Inc.

Clark Gilles Foundation

Colonial Youth & Family Services

Commack High School

Community Library Family Literacy

Community Mainstreaming Association

Comsewogue Youth Club

Contractors for Kids

Cooley's Anemia Foundation

Cub Scouts of America

Cure MS Foundation of NY

Doc Fallot Scholarship Fund

Dominican Sisters Family Health Services

East End Arts Council

Eden II and Genesis Foundation

Ericka Josephson Foundation

Father John Papallo Lodge

Fuoco Memorial Golf Festival

Federation of Organizations

Frank Catalanotto Foundation

Friends of Karen

Gallery North

Garden City Chamber of Commerce

Girl Scouts of Suffolk County

Greater Long Island Running Club

Greater Mastic Beach Chamber of Commerce

Hauppauge Industrial Association

Heckscher Museum of Art

Hope House Ministries

Island Harvest

James V. Kavanaugh Knights of Columbus

Jocelyn's Operation Holiday Spirit

Kara's Hope Foundation


Kelly Memorial Charitable Fund

Life's Women's Organization for Retarded Children

Long Island Museum

Lions Club of Medford – North Patchogue

Long Island Builders Institute, Inc.



Long Island Community Chest	Petra's Promise	Telecare
Long Island Council of Alcoholism & Drug Dependency	Port Jefferson Lions Club	Thomas Hartman Foundation
Long Island Imagine Awards	Richard J. O'Brien Memorial Foundation	Theodore Roosevelt Association
Long Island Real Estate Group	Ride for Life, Inc.	Three Village Kiwanis
Long Island University / Tilles Center	Rotary Club of Stony Brook Charities	Tomorrow's Hope Foundation
Marcum Workplace Challenge	Rotary Club of The Ronkonkomas	Touro Law Center
Maria Pashayan - SNT	Rotary Club of The Shirleys & Mastic	United Cerebral Palsy Suffolk
Mercy Haven	Salvation Army	United Way of Long Island
Metropolitan Mortgage Officers Society	School Business Partnerships of Long Island	Variety Child Learning Center
Michael W. McCarthy Foundation	Scope Education Services	Vietnam Veterans of America
Middle Country Library Foundation	Society of St. Vincent De Paul	Village of Port Jefferson – Dickens Festival
Middle Country Baseball	St. Charles Hospital Foundation	Wall of Wars Memorial
Miller Place Booster Club	St. Joseph's Church	Ward Melville Heritage Organization
Mineola Historical Society	St. Joseph's College	William Floyd Community Summit
Morgan Center	St. Jude RC	William Floyd Scholarship Fund & High School
National MS Society / LI Chapter	St. Louis De Montfort Church	Winthrop University Hospital
New Ground	Suffolk County Coalition Against Domestic Violence	Wounded Warrior Project
Our Lady Queen of Apostles	Suffolk Sports Hall of Fame	YMCA of Long Island



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