DNB FINANCIAL CORP /PA/
Form 10-Q
August 11, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

[X] Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the quarterly period ended: June 30, 2014

or

[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the transition period from ________________ to _____________

Commission File Number: 1-34242

DNB Financial Corporation

(Exact name of registrant as specified in its charter)

Pennsylvania	23-2222567

Pennsylvania	23-2222567	
(State or other jurisdiction of incorporation or organization)		(I.R.S. Employer Identification No.)

4 Brandywine Avenue - Downingtown, PA 19335

(Address of principal executive offices and Zip Code)

(610) 269-1040

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See definition of “accelerated filer”, “large accelerated filer”, and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock ($1.00 Par Value)	2,768,303 (Shares Outstanding as of August 11, 2014)
(Class)	

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DNB FINANCIAL CORPORATION AND SUBSIDIARY

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PART I – FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

DNB Financial Corporation and Subsidiary

Consolidated Statements of Financial Condition (Unaudited)

(Dollars in thousands, except share and per share data)	June 30, 2014	December 31, 2013
Assets		
Cash and due from banks	$ 28,428	$ 32,710
Federal Funds Sold	-	1,350
Cash and cash equivalents	28,428	34,060
Available-for-sale investment securities at fair value (amortized cost of $132,474 and $124,118)	131,702	121,659
Held-to-maturity investment securities (fair value of $63,361 and $63,402)	63,069	65,299
Total investment securities	194,771	186,958
Loans and leases	439,022	415,354
Allowance for credit losses	(4,887)	(4,623)
Net loans and leases	434,135	410,731
Restricted stock	2,820	2,903
Office property and equipment, net	7,973	8,218
Accrued interest receivable	2,248	2,297
Other real estate owned & other repossessed property	945	1,096
Bank owned life insurance (BOLI)	8,978	8,863
Core deposit intangible	91	111
Net deferred taxes	3,299	3,788
Other assets	1,474	2,448
Total assets	$ 685,162	$ 661,473
Liabilities and Stockholders’ Equity		
Liabilities		
Non-interest-bearing deposits	$ 116,989	$ 101,853
Interest-bearing deposits:		
NOW	174,044	170,427
Money market	133,479	130,835
Savings	63,844	60,090
Time	79,494	95,542

Brokered deposits	7,719	-
Total deposits	575,569	558,747
Federal Home Loan Bank of Pittsburgh (FHLBP) advances	10,000	10,000
Repurchase agreements	23,939	19,854
Junior subordinated debentures	9,279	9,279
Other borrowings	523	541
Total borrowings	43,741	39,674
Accrued interest payable	355	376
Other liabilities	3,800	4,093
Total liabilities	623,465	602,890
Stockholders’ Equity		
Preferred stock, $10.00 par value;		
1,000,000 shares authorized; $1,000 liquidation preference per share; 13,000 issued	13,000	12,995
Common stock, $1.00 par value;		
10,000,000 shares authorized; 2,896,937 and 2,896,703 issued, respectively; 2,763,333 and 2,753,931 outstanding, respectively	2,917	2,910
Treasury stock, at cost; 133,604 and 142,772, respectively	(2,461)	(2,629)
Surplus	34,592	34,441
Retained earnings	14,906	13,239
Accumulated other comprehensive loss	(1,257)	(2,373)
Total stockholders’ equity	61,697	58,583
Total liabilities and stockholders’ equity	$ 685,162	$ 661,473

See accompanying notes to unaudited consolidated financial statements.

DNB Financial Corporation and Subsidiary

Consolidated Statements of Income (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands, except per share data)	2014	2013	2014	2013
Interest Income:				
Interest and fees on loans and leases	$ 4,857	$ 4,875	$ 9,662	$ 9,699
Interest and dividends on investment securities:				
Taxable	739	720	1,449	1,401
Exempt from federal taxes	275	275	551	532
Interest on cash and cash equivalents	6	17	17	29
Total interest and dividend income	5,877	5,887	11,679	11,661
Interest Expense:				
Interest on NOW, money market and savings	132	188	287	382
Interest on time deposits	194	277	417	568
Interest in brokered deposits	5	-	5	-
Interest on FHLB advances	149	148	295	354
Interest on repurchase agreements	9	11	19	25
Interest on junior subordinated debentures	73	76	146	152
Interest on other borrowings	19	19	37	38
Total interest expense	581	719	1,206	1,519
Net interest income	5,296	5,168	10,473	10,142
Provision for credit losses	255	375	630	555
Net interest income after provision for credit losses	5,041	4,793	9,843	9,587
Non-interest Income:				
Service charges	302	315	632	660
Wealth management	325	301	636	592
Increase in cash surrender value of BOLI	57	58	115	116
Gain on sale of investment securities, net	102	155	337	214
Gain on sale of SBA loans	-	16	-	163
Other fees	328	314	613	613
Total non-interest income	1,114	1,159	2,333	2,358
Non-interest Expense:				
Salaries and employee benefits	2,472	2,251	4,975	4,615
Furniture and equipment	332	280	663	564
Occupancy	521	492	1,140	1,011
Professional and consulting	306	263	624	580
Advertising and marketing	196	167	351	327
Printing and supplies	48	47	87	88

FDIC insurance	120	158	232	263
PA shares tax	150	153	300	307
Telecommunications	63	57	120	115
Postage	22	20	42	41
Loss on sale or write down of OREO	1	18	7	28
Other expenses	443	366	827	721
Total non-interest expense	4,674	4,272	9,368	8,660
Income before income tax expense	1,481	1,680	2,808	3,285
Income tax expense	361	430	684	860
Net income	$ 1,120	$ 1,250	$ 2,124	$ 2,425
Preferred stock dividends and accretion of discount	33	36	70	73
Net income available to Common Shareholders	$ 1,087	$ 1,214	$ 2,054	$ 2,352
Earnings per common share:				
Basic	$ 0.39	$ 0.44	$ 0.74	$ 0.86
Diluted	$ 0.38	$ 0.44	$ 0.73	$ 0.85
Cash dividends per common share	$ 0.07	$ 0.07	$ 0.14	$ 0.14
Weighted average common shares outstanding:				
Basic	2,763,079	2,740,756	2,760,658	2,733,051
Diluted	2,809,851	2,773,637	2,806,164	2,767,847

See accompanying notes to unaudited consolidated financial statements.

DNB Financial Corporation and Subsidiary

Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	2014	2013	2014	2013
Net income	$ 1,120	$ 1,250	$ 2,124	$ 2,425
Other Comprehensive Income (Loss):				
Unrealized holding gains (losses) arising during the period				
Before tax amount	882	(1,993)	2,024	(2,161)
Tax effect	(300)	678	(688)	734
Net of tax	582	(1,315)	1,336	(1,427)
Accretion of discount on AFS to HTM reclassification(1)				
Before tax amount	2	6	4	14
Tax effect(2)	(1)	(1)	(2)	(4)
Net of tax	1	5	2	10
Less reclassification for gains included in net income				
Before tax amount	(102)	(155)	(337)	(214)
Tax effect(2)	35	52	115	73
Net of tax	(67)	(103)	(222)	(141)
Total other comprehensive income (loss)	516	(1,413)	1,116	(1,558)
Total comprehensive income (loss)	$ 1,636	$ (163)	$ 3,240	$ 867

(1) Amounts are included in interest and dividends on investment securities in the consolidated statements of income.

(2) Amounts are included in income tax expense in the consolidated statements of income.

See accompanying notes to unaudited consolidated financial statements.

DNB FINANCIAL CORPORATION AND Subsidiary

Consolidated Statements of Stockholders' Equity (Unaudited)

(Dollars in thousands)	Preferred Stock	Common Stock	Treasury Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance at January 1, 2014	$ 12,995	$ 2,910	$ (2,629)	$ 34,441	$ 13,239	$ (2,373)	$ 58,583
Net income for six months ended June 30, 2014	-	-	-	-	2,124	-	2,124
Other comprehensive income	-	-	-	-	-	1,116	1,116
SBLF issuance costs accretion	5	-	-	-	(5)	-	-
Restricted stock compensation expense	-	7	-	98	-	-	105
Exercise of stock options (500 shares)	-	-	-	4	-	-	4
Stock option compensation expense	-	-	-	30	-	-	30
Cash dividends - common ($0.14 per share)	-	-	-	-	(387)	-	(387)
Cash dividends SBLF preferred	-	-	-	-	(65)	-	(65)
Sale of treasury shares to 401(k) (6,091 shares)	-	-	112	13	-	-	125
Sale of treasury shares to deferred comp. plan (3,077 shares)	-	-	56	6	-	-	62
Balance at June 30, 2014	$ 13,000	$ 2,917	$ (2,461)	$ 34,592	$ 14,906	$ (1,257)	$ 61,697

(Dollars in thousands)	Preferred Stock	Common Stock	Treasury Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance at January 1, 2013	$ 12,978	$ 2,899	$ (2,999)	$ 34,274	$ 10,236	$ (683)	$ 56,705
Net income for six months ended June 30, 2013	-	-	-	-	2,425	-	2,425
Other comprehensive loss	-	-	-	-	-	(1,558)	(1,558)
SBLF issuance costs accretion	8	-	-	-	(8)	-	-
Restricted stock compensation expense	-	6	-	66	-	-	72
Stock option compensation expense	-	-	-	34	-	-	34
Cash dividends - common ($0.14 per share)	-	-	-	-	(383)	-	(383)
Cash dividends SBLF preferred	-	-	-	-	(65)	-	(65)
Sale of treasury shares to 401(k) (7,096 shares)	-	-	131	(16)	-	-	115
	-	-	66	(8)	-	-	58

Sale of treasury shares to deferred comp. plan (3,600 shares)							
Balance at June 30, 2013	$ 12,986	$ 2,905	$ (2,802)	$ 34,350	$ 12,205	$ (2,241)	$ 57,403

See accompanying notes to unaudited consolidated financial statements.

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DNB Financial Corporation and Subsidiary

Consolidated Statements of Cash Flows (Unaudited)

	Six Months Ended June 30,			
(Dollars in thousands)		2014		2013
Cash Flows From Operating Activities:				
Net income	$	2,124	$	2,425
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation, amortization and accretion		916		1,110
Provision for credit losses		630		555
Stock based compensation		135		106
Net gain on sale of securities		(337)		(214)
Net loss on sale and write down of OREO and other repossessed property		7		28
Earnings from investment in BOLI		(115)		(116)
Deferred tax benefit		(87)		-
Proceeds from sales of SBA loans		-		2,740
SBA loans originated for sale		-		(2,577)
Gain on sale of SBA loans		-		(163)
Decrease in accrued interest receivable		49		7
Decrease in other assets		976		2,047
Decrease in accrued interest payable		(21)		(25)
Decrease in other liabilities		(293)		(304)
Net Cash Provided By Operating Activities		3,984		5,619
Cash Flows From Investing Activities:				
Activity in available-for-sale securities:				
Sales		26,884		22,549
Maturities, repayments and calls		15,690		11,994

Purchases		(51,146)		(33,663)
Activity in held-to-maturity securities:				
Sales		1,228		-
Maturities, repayments and calls		1,119		3,459
Purchases		-		(4,714)
Net decrease in restricted stock		83		462
Net (increase) decrease in loans and leases		(24,076)		3,767
Net purchases of property and equipment, less proceeds from disposals		(212)		(117)
Proceeds from sale of OREO and other repossessed property		186		122
Net Cash (Used in) Provided by Investing Activities		(30,244)		3,859
Cash Flows From Financing Activities:				
Net increase in deposits		16,822		31,484
Repayment of FHLBP advances		-		(10,000)
Net increase in repurchase agreements		4,085		6,219
Decrease in other borrowings		(18)		(15)
Dividends paid		(452)		(448)
Proceeds from the exercise of stock options		4		-
Sale of treasury stock		187		173
Net Cash Provided by Financing Activities		20,628		27,413
Net Change in Cash and Cash Equivalents		(5,632)		36,891
Cash and Cash Equivalents at Beginning of Period		34,060		17,149
Cash and Cash Equivalents at End of Period	$	28,428	$	54,040
Supplemental Disclosure of Cash Flow Information:				
Cash paid during the period for:				
Interest	$	1,227	$	1,544
Income taxes		392		1,503
Supplemental Disclosure of Non-cash Flow Information:				
Transfers from loans and leases to real estate owned and other repossessed property		42		2,238

See accompanying notes to unaudited consolidated financial statements.

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DNB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1: BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of DNB Financial Corporation (referred to herein as the "Corporation" or "DNB") and its subsidiary, DNB First, National Association (the "Bank") have been prepared in accordance with the instructions for Form 10-Q and therefore do not include certain information or footnotes necessary for the presentation of financial condition, statement of operations and statement of cash flows required by generally accepted accounting principles. However, in the opinion of management, the consolidated financial statements reflect all adjustments (which consist of normal recurring adjustments) necessary for a fair presentation of the results for the unaudited periods. Prior amounts not affecting net income are reclassified when necessary to conform to current period classifications. The results of operations for the three and six months ended June 30, 2014 are not necessarily indicative of the results which may be expected for the entire year. The consolidated financial statements should be read in conjunction with the Annual Report and report on Form 10-K for the year ended December 31, 2013.

Subsequent Events-- Management has evaluated events and transactions occurring subsequent to June 30, 2014 for items that should potentially be recognized or disclosed in these Consolidated Financial Statements. The evaluation was conducted through the date these financial statements were issued.

Recent Accounting Pronouncements-

Accounting Standards Update (ASU) No. 2014 04, Receivables (Topic 310): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.

In January 2014, the FASB issued ASU 2014-04 "Receivables-Troubled Debt Restructurings by Creditors (Subtopic 310-40)." The amendments in this update clarify that an in-substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this update are effective for annual periods and interim periods within those annual periods beginning after December 15, 2014. DNB does not expect the adoption of this FASB ASU to have a material impact on the consolidated financial statements.

Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606)

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contract with Customers (Topic 606). The guidance in this update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following five steps: 1) identify the contracts(s) with the customer; 2) identify the performance obligations in the contract; 3) determine the transaction price; 4) allocate the transaction price to the performance obligations in the contract; and 5) recognize revenue when (or as) the entity satisfies a performance obligation. The guidance also specifies the accounting for some costs to obtain or fulfill a contract with a customer. For a public entity, the amendments in this update are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. DNB is still evaluating the effect of this amendment on DNB's consolidated financial statements.

DNB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 2: INVESTMENT SECURITIES

The amortized cost and fair values of investment securities, as of the dates indicated, are summarized as follows:

	June 30, 2014			
(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Held To Maturity				
US Government agency obligations	$ 7,611	$ 230	$ -	$ 7,841
Government Sponsored Entities (GSE) mortgage-backed securities	4,193	176	-	4,369
Corporate bonds	6,277	472	-	6,749
Collateralized mortgage obligations GSE	4,388	8	(38)	4,358
State and municipal tax-exempt	40,600	400	(956)	40,044
Total	$ 63,069	$ 1,286	$ (994)	$ 63,361
Available For Sale				
US Government agency obligations	$ 17,261	$ -	$ (196)	$ 17,065
GSE mortgage-backed securities	71,037	456	(196)	71,297
Collateralized mortgage obligations GSE	22,587	24	(765)	21,846
Corporate bonds	20,201	58	(147)	20,112
State and municipal tax-exempt	611	-	(3)	608
Certificates of deposit	750	7	-	757
Equity securities	27	2	(12)	17
Total	$ 132,474	$ 547	$ (1,319)	$ 131,702

	December 31, 2013			
(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Held To Maturity				

US Government agency obligations	$ 7,494	$ 75	$ -	$ 7,569
Government Sponsored Entities (GSE) mortgage-backed securities	5,934	200	-	6,134
Corporate bonds	6,357	249	-	6,606
Collateralized mortgage obligations GSE	4,903	10	(89)	4,824
State and municipal tax-exempt	40,611	83	(2,425)	38,269
Total	$ 65,299	$ 617	$ (2,514)	$ 63,402
Available For Sale				
US Government agency obligations	$ 30,522	$ 4	$ (583)	$ 29,943
GSE mortgage-backed securities	49,448	180	(698)	48,930
Collateralized mortgage obligations GSE	23,836	18	(968)	22,886
Corporate bonds	16,944	-	(394)	16,550
State and municipal tax-exempt	2,091	-	(19)	2,072
Certificates of deposit	1,250	10	-	1,260
Equity securities	27	2	(11)	18
Total	$ 124,118	$ 214	$ (2,673)	$ 121,659

Included in unrealized losses are market losses on securities that have been in a continuous unrealized loss position for twelve months or more and those securities that have been in a continuous unrealized loss position for less than twelve months. The following table details the aggregate unrealized losses and aggregate fair value of the underlying securities whose fair values are below their amortized cost at June 30, 2014 and December 31, 2013.

DNB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

	June 30, 2014					
(Dollars in thousands)	Total Fair Value	Total Unrealized Loss	Fair Value Impaired Less Than 12 Months	Unrealized Loss Less Than 12 Months	Fair Value Impaired More Than 12 Months	Unrealized Loss More Than 12 Months
Held To Maturity						
Collateralized mortgage obligations GSE	$ 4,097	$ (38)	$ 4,097	$ (38)	$ -	$ -
State and Municipal tax-exempt	23,576	(956)	2,772	(5)	20,804	(951)
Total	$ 27,673	$ (994)	$ 6,869	$ (43)	$ 20,804	$ (951)
Available For Sale						
US Government agency obligations	$ 17,065	$ (196)	$ 998	$ (2)	$ 16,067	$ (194)
GSE mortgage-backed securities	12,142	(196)	4,642	(31)	7,500	(165)
Collateralized mortgage obligations GSE	17,079	(765)	2,528	(58)	14,551	(707)
Corporate bonds	9,125	(147)	3,961	(36)	5,164	(111)
State and Municipal tax-exempt	608	(3)	-	-	608	(3)
Equity securities	11	(12)	-	-	11	(12)
Total	$ 56,030	$ (1,319)	$ 12,129	$ (127)	$ 43,901	$ (1,192)

	December 31, 2013					
(Dollars in thousands)	Total Fair Value	Total Unrealized Loss	Fair Value Impaired Less Than 12 Months	Unrealized Loss Less Than 12 Months	Fair Value Impaired More Than 12 Months	Unrealized Loss More Than 12 Months
Held To Maturity						
Collateralized mortgage obligations GSE	$ 2,530	$ (89)	$ 2,530	$ (89)	$ -	$ -
State and municipal tax-exempt	29,142	(2,425)	17,434	(727)	11,708	(1,698)
Total	$ 31,672	$ (2,514)	$ 19,964	$ (816)	$ 11,708	$ (1,698)
Available For Sale						
	$ 24,931	$ (583)	$ 24,931	$ (583)	$ -	$ -

US Government agency obligations						
GSE mortgage-backed securities	38,255	(698)	38,255	(698)	-	-
Collateralized mortgage obligations GSE	21,416	(968)	20,336	(959)	1,080	(9)
Corporate bonds	16,549	(394)	10,968	(223)	5,581	(171)
State and municipal tax-exempt	1,072	(19)	300	(6)	772	(13)
Equity securities	12	(11)	-	-	12	(11)
Total	$ 102,235	$ (2,673)	$ 94,790	$ (2,469)	$ 7,445	$ (204)

As of June 30, 2014, there were six mortgage-backed securities, five corporate bonds, ten U.S. agency obligations, seventeen collateralized mortgage obligations, thirty-three tax-exempt municipalities, and five equity securities which were in an unrealized loss position. DNB does not intend to sell these securities and management of DNB does not expect to be required to sell any of these securities prior to a recovery of its cost basis. Management has reviewed all of these securities and believes that DNB will collect all principal and interest that is due on debt securities on a timely basis. Management does not believe any individual unrealized loss as of June 30, 2014 represents an other-than-temporary impairment. DNB reviews its investment portfolio on a quarterly basis judging each investment for other-than-temporary impairment (OTTI). The OTTI analysis focuses on duration and severity of impairment in determining of OTTI. As of June 30, 2014, the following securities were reviewed:

Collateralized mortgage obligations GSE There are seventeen impaired securities classified as collateralized mortgage obligations, eleven of which were impaired for more than 12 months. All of these securities were issued and insured by FNMA, FHLMC or GNMA. DNB receives monthly principal and interest payments on all of these securities on a timely basis and none of these agencies has ever defaulted on mortgage-backed principal or interest. DNB anticipates a recovery in the market value as the securities approach their maturity dates or if interest rates decline from June 30, 2014 levels. Management concluded that these securities were not other-than-temporarily impaired at June 30, 2014.

DNB FINANCIAL CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

State and municipal tax-exempt There are thirty-three impaired securities in this category, which are comprised of intermediate to long-term municipal bonds, thirty-one of which were impaired for more than 12 months. All of the issues carry an A or better underlying credit rating and were evaluated on the basis on their underlying fundamentals; included but not limited to annual financial reports, geographic location, population and debt ratios. In certain cases, options for calls reduce the effective duration and in turn, future market value fluctuations. All issues are performing and are expected to continue to perform in accordance with their respective contractual terms and conditions. There have not been disruptions of any payments, associated with any of these municipal securities. These bonds are investment grade and the value decline is related to the changes in interest rates. Of the thirty-three municipal securities, there are nineteen insured school districts, nine uninsured school districts, three uninsured townships, and two insured townships, all of which have strong underlying ratings. Management concluded that these securities were not other-than-temporarily impaired at June 30, 2014.

US Government agency obligations There are ten impaired securities classified as agencies, nine of which were impaired for more than 12 months. All of these securities were issued and insured by FHLB, FNMA, or FHLMC. DNB has received timely interest payments on all of these securities and none of these agencies has ever defaulted on their bonds. DNB anticipates a recovery in the market value as the securities approach their maturity dates. Management concluded that these securities were not other-than-temporarily impaired at June 30, 2014.

GSE mortgage-backed securities There are six impaired bonds classified as GSE mortgage-backed securities, four of which were impaired for more than 12 months. All of these securities were issued and insured by FNMA, FHLMC, or GNMA. DNB receives monthly principal and interest payments on all of these securities on a timely basis and none of these agencies has ever defaulted on mortgage-backed principal or interest. DNB anticipates a recovery in the market value as the securities approach their maturity dates or if interest rates decline from June 30, 2014 levels. Management concluded that these securities were not other-than-temporarily impaired at June 30, 2014.

Corporate Securities There were five impaired bonds classified as corporate bonds, three of which were impaired for more than 12 months. The bonds are investment grade and the value decline is related to the changes in interest rates that occurred since the time of purchase and subsequent changes in spreads affecting the market prices. All of the issues carry an "A" or better underlying credit support and were evaluated on the basis on their underlying fundamentals; included but not limited to annual financial reports, rating agency reports, capital strength and debt ratios. DNB anticipates a recovery in the market value as the securities approach their maturity dates or if interest rates decline from June 30, 2014 levels. Management concluded that these securities were not other-than-temporarily impaired at June 30, 2014.

Equity securities. DNB's investment in five marketable equity securities consists primarily of securities in common stock of community banks in Pennsylvania, all of which were impaired for more than 12 months. The severity and duration of the impairment are driven by higher collateral losses, wider credit spreads, and changes in interest rates within the financial services sector. DNB evaluated the prospects of all issuers in relation to the severity and duration of the impairment. These securities have been adversely impacted by the effects of the current economic environment on the financial services industry. We evaluated each of the underlying banks for credit impairment based on its financial condition and performance. Based on our evaluation and expectation that these investments will recover within a reasonable period of time, we do not consider these investments to be other-than-temporarily impaired at June 30, 2014.

The amortized cost and fair value of investment securities as of June 30, 2014, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because certain securities may be called or prepaid without penalties.

	Held to Maturity		Available for Sale	
	Amortized		Amortized	
(Dollars in thousands)	Cost	Fair Value	Cost	Fair Value
Due in one year or less	$ -	$ -	$ 2,051	$ 2,052
Due after one year through five years	1,003	984	24,182	23,951
Due after five years through ten years	32,023	32,620	63,327	63,612
Due after ten years	30,043	29,757	42,887	42,070
No stated maturity	-	-	27	17
Total investment securities	$ 63,069	$ 63,361	$ 132,474	$ 131,702

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The principal value of investments securites sold as of the dates indicated are shown below. The sales of HTM securities were permissible because DNB collected greater than 85% of the principal outstanding on the HTM securities that were sold during the six months ended June 30, 2014.

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	2014	2013	2014	2013
Available for sale securities sold	$ 11,653	$ 6,257	$ 26,884	$ 22,549
Held to maturity securities sold	-	-	1,228	-
Total sold securities	$ 11,653	$ 6,257	$ 28,112	$ 22,549

Gains and losses resulting from investment sales, redemptions or calls were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	2014	2013	2014	2013
Gross realized gains-AFS	$ 102	$ 155	$ 294	$ 471
Gross realized gains-HTM	-	-	68	
Gross realized losses-AFS	-	-	(25)	(257)
Net realized gain	$ 102	$ 155	$ 337	$ 214

At June 30, 2014 and December 31, 2013, investment securities with a carrying value of approximately $126.7 million and $116.2 million, respectively, were pledged to secure public funds, repurchase agreements and for other purposes as required by law.

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NOTE 3: LOANS

The following table sets forth information concerning the composition of total loans and leases outstanding, as of the dates indicated.

(Dollars in thousands)	June 30, 2014	December 31, 2013
Residential mortgage	$ 25,337	$ 24,677
Commercial mortgage	250,014	234,599
Commercial:		
Commercial term	87,912	89,279
Commercial construction	22,842	19,117
Lease financing	1	2
Consumer:		
Home equity	46,857	41,418
Other	6,059	6,262
Total loans and leases	$ 439,022	$ 415,354
Less allowance for credit losses	(4,887)	(4,623)
Net loans and leases	$ 434,135	$ 410,731

Information concerning non-accrual loans are shown in the following tables:

			Three Months Ended June 30, 2014			Six Months Ended June 30, 2014		
(Dollars in thousands)	December 31, 2013 Balances	June 30, 2014 Balances	Interest income that would have been recorded under original terms	Interest income recorded during the period	Net impact on interest income	Interest income that would have been recorded under original terms	Interest income recorded during the period	Net impact on interest income
Non-accrual loans:								

Residential mortgage	$ 2,250	$ 1,734	$ 8	$ -	$ 8	$ 24	$ -	$ 24
Commercial mortgage	266	192	4	-	4	9	-	9
Commercial:								
Commercial term	-	-	-	-	-	-	-	-
Commercial construction	2,554	2,293	86	-	86	180	-	180
Lease financing	-	-	-	-	-	-	-	-
Consumer:								
Home Equity	434	346	7	2	5	14	3	11
Other	82	99	2	-	2	5	-	5
Total non-accrual loans	$ 5,586	$ 4,664	$ 107	$ 2	$ 105	$ 232	$ 3	$ 229
Loans 90 days past due and accruing	141	501						
Total non-performing loans	$ 5,727	$ 5,165						

		Three Months Ended June 30, 2013			Six Months Ended June 30, 2013		
(Dollars in thousands)	June 30, 2013 Balances	Interest income that would have been recorded under original terms	Interest income recorded during the period	Net impact on interest income	Interest income that would have been recorded under original terms	Interest income recorded during the period	Net impact on interest income
Non-accrual loans:							
Residential mortgage	$ 2,265	$ 17	$ -	$ 17	$ 35	$ -	$ 35
Commercial mortgage	3,286	48	-	48	114	-	114
Commercial:							
Commercial term	-	3	-	3	4	-	4
Commercial construction	4,326	90	-	90	212	-	212
Lease financing	-	-	-	-	1	-	1
Consumer:							
Home Equity	60	2	-	2	3	-	3
Other	102	5	3	2	9	3	6
Total non-accrual loans	$ 10,039	$ 165	$ 3	$ 162	$ 378	$ 3	$ 375
Loans 90 days past due and accruing	106						
Total non-performing loans	$ 10,145						

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NOTE 4: ALLOWANCE FOR CREDIT LOSSES

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a scheduled payment is past due. The following tables present the classes of the loan portfolio summarized by the past due status as of June 30, 2014 and December 31, 2013.

Age Analysis of Past Due Loans Receivables

June 30, 2014

(Dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans Receivables	Loans Receivable > 90 Days and Accruing
Residential mortgage	$ 306	$ 465	$ 2,234	$ 3,005	$ 22,332	$ 25,337	$ 500
Commercial mortgage	1,322	202	35	1,559	248,455	250,014	-
Commercial:							
Commercial term	-	-	-	-	87,912	87,912	-
Commercial construction	-	-	2,293	2,293	20,549	22,842	-
Lease financing	-	-	1	1	-	1	1
Consumer:							
Home equity	6	-	263	269	46,588	46,857	-
Other	114	69	99	282	5,777	6,059	-
Total	$ 1,748	$ 736	$ 4,925	$ 7,409	$ 431,613	$ 439,022	$ 501

December 31, 2013

	30-59 Days Past	60-89 Days Past	Greater than	Total		Total Loans	Loans Receivable > 90 Days and

(Dollars in thousands)	Due	Due	90 Days	Past Due	Current	Receivables	Accruing
Residential mortgage	$ 507	$ 865	$ 1,757	$ 3,129	$ 21,548	$ 24,677	$ -
Commercial mortgage	358	192	74	624	233,975	234,599	-
Commercial:							
Commercial term	50	-	-	50	89,229	89,279	-
Commercial construction	-	-	2,554	2,554	16,563	19,117	-
Lease financing	-	-	2	2	-	2	2
Consumer:							
Home equity	-	50	376	426	40,992	41,418	67
Other	80	-	77	157	6,105	6,262	72
Total	$ 995	$ 1,107	$ 4,840	$ 6,942	$ 408,412	$ 415,354	$ 141

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The following tables summarize information in regards to impaired loans by loan portfolio class as of and for the three and six months ended June 30, 2014 and as of and for the year ended December 31, 2013.

Impaired Loans

	June 30, 2014			December 31, 2013		
(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Residential mortgage	$ 1,734	$ 2,321	$ -	$ 2,250	$ 2,848	$ -
Commercial mortgage	2,499	2,579	-	2,502	2,574	-
Commercial:						
Commercial term	-	-	-	-	3	-
Commercial construction	1,094	1,877	-	499	3,355	-
Consumer:						
Home equity	460	472	-	434	442	-
Other	27	31	-	78	78	-
Total	$ 5,814	$ 7,280	$ -	$ 5,763	$ 9,300	$ -
With allowance recorded:						
Residential mortgage	-	-	-	-	-	-
Commercial mortgage	-	-	-	36	36	14
Commercial:						
Commercial term	-	-	-	-	-	-
Commercial construction	1,312	4,976	276	2,055	3,386	361
Consumer:						
Home equity	-	-	-	-	-	-
Other	72	72	24	4	4	4
Total	$ 1,384	$ 5,048	$ 300	$ 2,095	$ 3,426	$ 379
Total:						
Residential mortgage	1,734	2,321	-	2,250	2,848	-
Commercial mortgage	2,499	2,579	-	2,538	2,610	14
Commercial:						
Commercial term	-	-	-	-	3	-
Commercial construction	2,406	6,853	276	2,554	6,741	361
Consumer:						

Home equity	460	472	-	434	442	-
Other	99	103	24	82	82	4
Total	$ 7,198	$ 12,328	$ 300	$ 7,858	$ 12,726	$ 379

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	Three Months Ended June 30, 2014		Three Months Ended June 30, 2013		Six Months Ended June 30, 2014		Six Months Ende June 30, 2013	
(Dollars in thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Int Inc Re
With no related allowance recorded:								
Residential mortgage	$ 1,614	$ -	$ 2,414	$ -	$ 1,826	$ -	$ 2,405	$ -
Commercial mortgage	2,508	-	2,250	-	2,506	-	2,436	-
Commercial:								
Commercial term	-	-	-	-	-	-	-	-
Commercial construction	1,094	-	1,091	-	896	-	727	-
Lease financing	-	-	13	-	-	-	18	-
Consumer:								
Home equity	428	2	61	-	430	3	62	-
Other	22	-	124	3	40	-	132	3
Total	$ 5,666	$ 2	$ 5,953	$ 3	$ 5,698	$ 3	$ 5,780	$ 3
With allowance recorded:								
Residential mortgage	377	-	159	-	251	-	106	-
Commercial mortgage	18	-	2,392	-	24	-	2,449	-
Commercial:								
Commercial term	-	-	100	-	-	-	67	-
Commercial construction	1,312	-	4,326	-	1,560	-	4,326	-
Lease financing	-	-	-	-	-	-	-	-
Consumer:								

Home equity	-	-	-	-	-	-	-	-
Other	105	-	-	-	71	-	-	-
Total	$ 1,811	$ -	$ 6,977	$ -	$ 1,906	$ -	$ 6,948	$ -
Total:								
Residential mortgage	1,991	-	2,573	-	2,077	-	2,511	-
Commercial mortgage	2,526	-	4,642	-	2,530	-	4,885	-
Commercial:								
Commercial term	-	-	100	-	-	-	67	-
Commercial construction	2,406	-	5,417	-	2,456	-	5,053	-
Lease financing	-	-	13	-	-	-	18	-
Consumer:								
Home equity	428	2	61	-	430	3	62	-
Other	127	-	124	3	111	-	132	3
Total	$ 7,477	$ 2	$ 12,930	$ 3	$ 7,604	$ 3	$ 12,728	$ 3

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The following tables present the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within DNB's internal risk rating system as of June 30, 2014 and December 31, 2013.

Credit Quality Indicators

	June 30, 2014				
(Dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage	$ 23,321	$ -	$ 2,016	$ -	$ 25,337
Commercial mortgage	240,201	415	9,398	-	250,014
Commercial:					
Commercial term	82,192	72	5,648	-	87,912
Commercial construction	18,767	-	3,375	700	22,842
Lease financing	1	-	-	-	1
Consumer:					
Home equity	46,362	-	495	-	46,857
Other	5,961	-	98	-	6,059
Total	$ 416,805	$ 487	$ 21,030	$ 700	$ 439,022

	December 31, 2013				
(Dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
Residential mortgage	$ 22,142	$ -	$ 2,535	$ -	$ 24,677
Commercial mortgage	224,868	5,028	4,703	-	234,599
Commercial:					
Commercial term	88,657	419	203	-	89,279
Commercial construction	16,450	-	1,967	700	19,117
Lease financing	2	-	-	-	2
Consumer:					
Home equity	40,940	-	478	-	41,418
Other	6,180	-	82	-	6,262

Total	$ 399,239	$ 5,447	$ 9,968	$ 700	$ 415,354

As of June 30, 2014, DNB had one commercial mortgage classified as a TDR totaling $2,269,000, compared to one commercial mortgage classified as a TDR totaling $2,272,000 (the same loan) at December 31, 2013. The rate on this loan was modified and the terms of the loans were changed to interest only while the project was being built out. The loan was extended and there was no reduction of principal. The balance of the loan prior to modification was $2,272,000 and the balance after the modification was $2,272,000. During the three and six months ended June 30, 2014, there were no defaults on any terms of this loan. DNB had no TDRs as of June 30, 2013.

As of June 30, 2014, DNB had one consumer home equity loan classified as a TDR totaling $102,000, compared to no such loans at December 31, 2013 and March 31, 2014. The monthly payment on this loan was reduced for 36 months and the borrower will resume making contractual payments at the end of this period. The loan was extended and there was no reduction of principal. This loan was classified a TDR in June of 2014. The balance of the loan prior to modification was $102,000 and the balance after the modification was $102,000. During the three and six months ended June 30, 2014, there were no defaults on any terms of this loan.

The following tables set forth the composition of DNB's allowance for credit losses as of June 30, 2014 and December 31, 2013, the activity for the three and six months ended June 30, 2014 and 2013 and as of and for the year ended December 31, 2013.

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Allowance for Credit Losses and Recorded Investment in Loans Receivables

(Dollars in thousands)	Residential mortgage	Commercial mortgage	Commercial term	Commercial construction	Lease financing	Consumer home equity	Consumer Other	Unallocated	Total
Allowance for credit losses:									
Beginning balance - April 1, 2014	$ 347	$ 2,146	$ 652	$ 806	$ -	$ 167	$ 125	$ 507	$ 4,750
Charge-offs	(100)	(8)	(11)	-	-	-	(11)	-	(130)
Recoveries	2	-	2	-	5	-	3	-	12
Provisions	66	(7)	(2)	213	(5)	9	(19)	-	255
Ending balance - June 30, 2014	$ 315	$ 2,131	$ 641	$ 1,019	$ -	$ 176	$ 98	$ 507	$ 4,887

(Dollars in thousands)	Residential mortgage	Commercial mortgage	Commercial term	Commercial construction	Lease financing	Consumer home equity	Consumer Other	Unallocated	Total
Allowance for credit losses:									
Beginning balance - January 1, 2014	$ 285	$ 2,010	$ 621	$ 1,033	$ -	$ 156	$ 78	$ 440	$ 4,623
Charge-offs	(100)	(8)	(18)	(261)	-	-	(11)	-	(398)
Recoveries	5	-	2	10	6	-	9	-	32
Provisions	125	129	36	237	(6)	20	22	67	630
Ending balance - June 30, 2014	$ 315	$ 2,131	$ 641	$ 1,019	$ -	$ 176	$ 98	$ 507	$ 4,887
Ending balance: individually evaluated for impairment	$ -	$ -	$ -	$ 276	$ -	$ -	$ 24	$ -	$ 300
Ending balance: collectively evaluated for impairment	$ 315	$ 2,131	$ 641	$ 743	$ -	$ 176	$ 74	$ 507	$ 4,587
Loans receivables:									

Ending balance	$ 25,337	$ 250,014	$ 87,912	$ 22,842	$ 1	$ 46,857	$ 6,059		$ 439,022
Ending balance: individually evaluated for impairment	$ 1,734	$ 2,499	$ -	$ 2,406	$ -	$ 460	$ 99		$ 7,198
Ending balance: collectively evaluated for impairment	$ 23,603	$ 247,515	$ 87,912	$ 20,436	$ 1	$ 46,397	$ 5,960		$ 431,824
Reserve for unfunded loan commitments included in other liabilities	$ -	$ 10	$ 79	$ 60	$ -	$ 11	$ -		$ 160

(Dollars in thousands)	Residential mortgage	Commercial mortgage	Commercial term	Commercial construction	Lease financing	Consumer home equity	Consumer Other	Unallocated	Total
Allowance for credit losses:									
Beginning balance - April 1, 2013	$ 327	$ 3,248	$ 711	$ 1,930	$ 2	$ 180	$ 83	$ 642	$ 7,123
Charge-offs	(184)	(394)	(212)	-	(26)	-	-	-	(816)
Recoveries	5	-	1	-	2	-	-	-	8
Provisions	161	256	(16)	74	22	1	(3)	(120)	375
Ending balance - June 30, 2013	$ 309	$ 3,110	$ 484	$ 2,004	$ -	$ 181	$ 80	$ 522	$ 6,690

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(Dollars in thousands)	Residential mortgage	Commercial mortgage	Commercial term	Commercial construction	Lease financing	Consumer home equity	Consumer Other	Unallocated	Total
Allowance for credit losses:									
Beginning balance - January 1, 2013	$ 306	$ 3,094	$ 506	$ 1,536	$ 3	$ 178	$ 86	$ 1,129	$ 6,838
Charge-offs	(184)	(394)	(222)	-	(26)	-	(5)	-	(831)
Recoveries	70	-	5	-	53	-	-	-	128
Provisions	117	410	195	468	(30)	3	(1)	(607)	555
Ending balance - June 30, 2013	$ 309	$ 3,110	$ 484	$ 2,004	$ -	$ 181	$ 80	$ 522	$ 6,690
Reserve for unfunded loan commitments included in other liabilities	$ -	$ 11	$ 81	$ 41	$ -	$ 9	$ -		$ 142

(Dollars in thousands)	Residential mortgage	Commercial mortgage	Commercial term	Commercial construction	Lease financing	Consumer home equity	Consumer Other	Unallocated	Total
Allowance for credit losses:									
Ending balance - December 31, 2013	$ 285	$ 2,010	$ 621	$ 1,033	$ -	$ 156	$ 78	$ 440	$ 4,623
Ending balance: individually evaluated for impairment	$ -	$ 14	$ -	$ 361	$ -	$ -	$ 4	$ -	$ 379
Ending balance: collectively evaluated for impairment	$ 285	$ 1,996	$ 621	$ 672	$ -	$ 156	$ 74	$ 440	$ 4,244
Loans receivables:									
Ending balance	$ 24,677	$ 234,599	$ 89,279	$ 19,117	$ 2	$ 41,418	$ 6,262		$ 415,354
Ending balance: individually evaluated for impairment	$ 2,250	$ 2,538	$ -	$ 2,554	$ -	$ 434	$ 82		$ 7,858
Ending balance: collectively evaluated for impairment	$ 22,427	$ 232,061	$ 89,279	$ 16,563	$ 2	$ 40,984	$ 6,180		$ 407,496
Reserve for unfunded loan commitments included in other liabilities	$ -	$ 9	$ 68	$ 57	$ -	$ 9	$ -		$ 143

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NOTE 5: EARNINGS PER SHARE

Basic earnings per share ("EPS") is computed based on the weighted average number of common shares outstanding during the period. Diluted EPS is computed using the treasury stock method and reflects the potential dilution that could occur from the exercise of stock options, and warrants and the amortized portion of unvested stock awards. Stock options and unvested stock awards for which the exercise or the grant price exceeds the average market price over the period have an anti-dilutive effect on EPS and, accordingly, are excluded from the calculation. Treasury shares are not deemed outstanding for calculations. There were no outstanding stock warrants, 66,853 anti-dilutive stock options outstanding, and no anti-dilutive stock awards outstanding at June 30, 2014. There were no anti-dilutive stock warrants outstanding, 128,568 anti-dilutive stock options outstanding, and no anti-dilutive stock awards outstanding at June 30, 2013. The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended June 30, 2014			Six Months Ended June 30, 2014		
(In thousands, except per-share data)	Income	Shares	Amount	Income	Shares	Amount
Basic EPS						
Income available to common stockholders	$ 1,087	2,763	$ 0.39	$ 2,054	2,761	$ 0.74
Effect of potential dilutive common stock equivalents – stock options and restricted shares	-	47	(0.01)	-	45	(0.01)
Diluted EPS						
Income available to common stockholders after assumed conversions	$ 1,087	2,810	$ 0.38	$ 2,054	2,806	$ 0.73

	Three Months Ended	Six Months Ended

(In thousands, except per-share data)	June 30, 2013 Income	Shares	Amount	June 30, 2013 Income	Shares	Amount
Basic EPS						
Income available to common stockholders	$ 1,214	2,741	$ 0.44	$ 2,352	2,733	$ 0.86
Effect of potential dilutive common stock equivalents – stock options and restricted shares	-	33	-	-	35	(0.01)
Diluted EPS						
Income available to common stockholders after assumed conversions	$ 1,214	2,774	$ 0.44	$ 2,352	2,768	$ 0.85

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NOTE 6: ACCUMULATED OTHER COMPREHENSIVE LOSS

The components of accumulated other comprehensive loss included in stockholders' equity are as follows:

Accumulated Other Comprehensive Loss (Unaudited) (Dollars in thousands)	Before-Tax Amount	Tax Effect	Net-of-Tax Amount
June 30, 2014			
Net unrealized loss on AFS securities	$ (772)	$ 263	$ (509)
Discount on AFS to HTM reclassification	(28)	9	(19)
Unrealized actuarial losses-pension	(1,104)	375	(729)
Total of all items above	$ (1,904)	$ 647	$ (1,257)
December 31, 2013			
Net unrealized loss on AFS securities	$ (2,459)	$ 836	$ (1,623)
Discount on AFS to HTM reclassification	(32)	11	(21)
Unrealized actuarial losses-pension	(1,104)	375	(729)
Total of all items above	$ (3,595)	$ 1,222	$ (2,373)

NOTE 7: JUNIOR SUBORDINATED DEBENTURES

DNB has two issuances of junior subordinated debentures (the “debentures”) as follows. The majority of the proceeds of each issuance were invested in DNB’s subsidiary, DNB First, National Association, to increase the Bank’s capital levels. The junior subordinated debentures issued in each case qualify as a component of capital for regulatory purposes. DNB Capital Trust I and II are special purpose Delaware business trusts, which are not consolidated.

DNB Capital Trust I

DNB's first issuance of junior subordinated debentures was on July 20, 2001. These debentures are floating rate and were issued to DNB Capital Trust I, a Delaware business trust in which DNB owns all of the common equity. DNB Capital Trust I issued $5.0 million of floating rate (6 month Libor plus 3.75%, with a cap of 12%) capital preferred securities to a qualified institutional buyer. The proceeds of these securities were used by the Trust, along with DNB's capital contribution, to purchase $5.2 million principal amount of DNB's floating rate junior subordinated debentures. The preferred securities have been redeemable since July 25, 2006 and must be redeemed upon maturity of the debentures on July 25, 2031.

DNB Capital Trust II

DNB's second issuance of junior subordinated debentures was on March 30, 2005. These are floating rate and were issued to DNB Capital Trust II, a Delaware business trust in which DNB owns all of the common equity. DNB Capital Trust II issued $4.0 million of floating rate (the rate was fixed at 6.56% for the first 5 years and is now adjusting at a rate of 3-month LIBOR plus 1.77%) capital preferred securities. The proceeds of these securities were used by the Trust, along with DNB's capital contribution, to purchase $4.1 million principal amount of DNB's floating rate junior subordinated debentures. The preferred securities have been redeemable since May 23, 2010. The preferred securities must be redeemed upon maturity of the debentures on May 23, 2035.

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NOTE 8: STOCK-BASED COMPENSATION

Stock Option Plan

DNB has a Stock Option Plan for employees and directors. Under the plan, options (both qualified and non-qualified) to purchase a maximum of 793,368 (as adjusted for subsequent stock dividends) shares of DNB's common stock could be issued to employees and directors. Under the plan, option exercise prices must equal the fair market value of the shares on the date of option grant and the option exercise period may not exceed ten years. Vesting of options under the plan is determined by the Plan Committee. There were 335,279 shares available for grant at June 30, 2014. All options with the exception of 44,600 options granted on December 12, 2011 are immediately exercisable. DNB expensed $13,000 and $30,000 during the three and six months ended June 30, 2014, respectively compared to $17,000 and $34,000 during the same respective periods in 2013. DNB anticipates additional expense of $20,000 through December 12, 2014 for the options granted on December 12, 2011, the dates the options can first be exercised. Stock option activity is indicated below.

	Number Outstanding		Weighted Average Exercise Price
Outstanding January 1, 2014	207,303	$	15.92
Issued	-		-
Exercised	500		6.93
Forfeited	-		-
Expired	-		-
Outstanding June 30, 2014	206,803	$	15.94

	Number Outstanding		Weighted Average Exercise Price
Outstanding January 1, 2013	214,618	$	15.98
Issued	-		-

Exercised	-	-
Forfeited	1,000	10.31
Expired	-	-
Outstanding June 30, 2013	213,618	$ 16.00

The weighted-average price and weighted average remaining contractual life for the outstanding options are listed below for the dates indicated.

June 30, 2014

Range of Exercise Prices	Number Outstanding	Number Exercisable	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Intrinsic Value
$ 6.93-10.99	84,550	41,200	$ 8.66	3.66 years	$ 1,064,000
14.00-19.99	55,401	55,401	17.51	1.48 years	207,000
20.00-22.99	18,811	18,811	22.78	0.48 years	-
23.00-24.27	48,041	48,041	24.27	0.80 years	-
Total	206,803	163,453	$ 15.94	2.12 years	$ 1,271,000

December 31, 2013

Range of Exercise Prices	Number Outstanding	Number Exercisable	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Intrinsic Value
$ 6.93-10.99	85,050	-	$ 8.65	4.15 years	$ 1,029,000
14.00-19.99	55,401	55,401	17.51	1.97 years	180,000
20.00-22.99	18,811	18,811	22.78	0.97 years	-
23.00-24.27	48,041	48,041	24.27	1.29 years	-
Total	207,303	122,253	$ 15.92	2.62 years	$ 1,209,000

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Other Stock-Based Compensation

DNB maintains an Incentive Equity and Deferred Compensation Plan (the "Plan"). The Plan provides that up to 243,101 (as adjusted for subsequent stock dividends) shares of common stock may be granted, at the discretion of the Board, to individuals of the Corporation. Shares already granted are issuable on the earlier of three years after the date of the grant or a change in control of DNB if the recipients are then employed by DNB (“Vest Date”). Upon issuance of the shares, resale of the shares is restricted for an additional one year, during which the shares may not be sold, pledged or otherwise disposed of. Prior to the Vest Date and in the event the recipient terminates association with DNB for reasons other than death, disability or change in control, the recipient forfeits all rights to the shares that would otherwise be issued under the grant.

Share awards granted by the Plan were recorded at the date of award based on the market value of shares. Awards are being amortized to expense over the three-year cliff-vesting period. DNB records compensation expense equal to the value of the shares being amortized. For the three and six month periods ended June 30, 2014, $52,000 and $105,000 was amortized to expense, respectively. For the three and six month periods ended June 30, 2013, $32,000 and $72,000 was amortized to expense, respectively. As of June 30, 2014, there was approximately $520,000 in additional compensation that will be recognized over the remaining service period of approximately 2.33 years. At June 30, 2014, 141,629 shares were reserved for future grants under the Plan.

Stock grant activity is indicated below:

	Shares		Weighted Average Stock Price
Non-vested stock awards—January 1, 2014	50,795	$	15.65
Granted	-		-
Forfeited	-		-

Vested	-	-
Non-vested stock awards—June 30, 2014	50,795	$ 15.65

	Shares	Weighted Average Stock Price
Non-vested stock awards—January 1, 2013	48,270	$ 11.39
Granted	-	-
Forfeited	400	15.56
Vested	14,200	6.93
Non-vested stock awards—June 30, 2013	33,670	$ 13.22

NOTE 9: INCOME TAXES

As of June 30, 2014, the Corporation had no material unrecognized tax benefits or accrued interest and penalties. It is the Corporation's policy to account for interest and penalties accrued relative to unrecognized tax benefits as a component of income tax expense. Federal and state tax years 2010 through 2013 were open for examination as of June 30, 2014.

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NOTE 10: FAIR VALUE OF FINANCIAL INSTRUMENTS

FASB ASC Topic 820, Fair Value Measurements and Disclosures, establishes a fair value hierarchy based on the nature of data inputs for fair value determinations, under which DNB is required to value each asset within its scope using assumptions that market participations would utilize to value that asset. When DNB uses its own assumptions, it is required to disclose additional information about the assumptions used and the effect of the measurement on earnings or the net change in assets for the period.

The three levels of the fair value hierarchy under FASB ASC Topic 820 are as follows:

Level 1—Quoted prices in active markets for identical securities.

Level 2—Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active and model derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3—Instruments whose significant value drivers are unobservable.

A description of the valuation methodologies used for assets measured at fair value is set forth below:

DNB's available-for-sale investment securities, which generally include U.S. government agencies and mortgage backed securities, collateralized mortgage obligations, corporate bonds and equity securities are reported at fair value. These securities are valued by an independent third party ("preparer"). The preparer's evaluations are based on market data. They utilize evaluated pricing models that vary by asset and incorporate available trade, bid and other market information. For securities that do not trade on a daily basis, their evaluated pricing applications apply available information such as benchmarking and matrix pricing. The market inputs normally sought in the evaluation of securities include benchmark yields, reported trades, broker/dealer quotes (only obtained from market makers or broker/dealers recognized as market participants), issuer spreads, two-sided markets, benchmark securities, bid, offers and reference data. For certain securities additional inputs may be used or some market inputs may not be applicable. Inputs are prioritized differently on any given day based on market conditions.

U.S. Government agencies are evaluated and priced using multi dimensional relational models and option adjusted spreads. State and municipal securities are evaluated on a series of matrices including reported trades and material event notices. Mortgage backed securities are evaluated using matrix correlation to treasury or floating index benchmarks, prepayment speeds, monthly payment information and other benchmarks. Other securities are evaluated using a broker-quote based application, including quotes from issuers.

Impaired loans are those loans that the Bank has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

OREO assets are adjusted to fair value less estimated selling costs upon transfer of the loans to OREO establishing a new cost basis. Subsequently, OREO assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. There assets are included as Level 3 fair values.

The following table summarizes the assets at June 30, 2014 and December 31, 2013 that are recognized on DNB's statement of financial condition using fair value measurement determined based on the differing levels of input:

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	June 30, 2014			
(Dollars in thousands)	Level 1	Level 2	Level 3	Fair Value
Assets Measured at Fair Value on a Recurring Basis				
AFS Investment Securities:				
US Government agency obligations	$ -	$ 17,065	$ -	$ 17,065
GSE mortgage-backed securities	-	71,297	-	71,297
Collateralized mortgage obligations GSE	-	21,846	-	21,846
Corporate bonds	-	20,112	-	20,112
State and municipal tax-exempt	-	608	-	608
Certificates of deposit	-	757	-	757
Equity securities	17	-	-	17
Total assets measured at fair value on a recurring basis	$ 17	$ 131,685	$ -	$ 131,702
Assets Measured at Fair Value on a Nonrecurring Basis				
Impaired loans	$ -	$ -	$ 2,804	$ 2,804
OREO and other repossessed property	-	-	42	42
Total assets measured at fair value on a nonrecurring basis	$ -	$ -	$ 2,846	$ 2,846

	December 31, 2013			
(Dollars in thousands)	Level 1	Level 2	Level 3	Fair Value
Assets Measured at Fair Value on a Recurring Basis				
AFS Investment Securities:				
US Government agency obligations	$ -	$ 29,943	$ -	$ 29,943
GSE mortgage-backed securities	-	48,930	-	48,930
Collateralized mortgage obligations GSE	-	22,886	-	22,886
Corporate bonds	-	16,550	-	16,550
State and municipal tax-exempt	-	2,072	-	2,072
Certficates of deposit	-	1,260	-	1,260
Equity securities	18	-	-	18

Total assets measured at fair value on a recurring basis	$ 18	$ 121,641	$ -	$ 121,659
Assets Measured at Fair Value on a Nonrecurring Basis				
Impaired loans	$ -	$ -	$ 2,829	$ 2,829
OREO and other repossessed property	-	-	124	124
Total assets measured at fair value on a nonrecurring basis	$ -	$ -	$ 2,953	$ 2,953

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The following table presents additional information about assets measured at fair value on a nonrecurring basis and for which DNB has utilized Level 3 inputs to determine fair value:

Quantitative Information about Level 3 Fair Value Measurement

(Dollars in thousands)	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)
June 30, 2014				
Impaired loans- Commercial construction	$ 2,130	Appraisal of collateral (1)	Appraisal adj.	0% to -47% (-17%)
			Disposal costs (2)	-8% to -11% (-10%)
Impaired loans- Residential mortgage	626	Appraisal of collateral (1)	Appraisal adj.	0% to 0% (0%)
			Disposal costs (2)	-8% to -8% (-8%)
Impaired loans- Consumer other	48	Appraisal of collateral (1)	Appraisal adj.	0% to 0% (0%)
			Disposal costs (2)	-8% to -8% (-8%)
Impaired loan total	$ 2,804			
Other real estate owned (1)	$ 42		Disposal costs (2)	-8% to -8% (-8%)

Quantitative Information about Level 3 Fair Value Measurement

(Dollars in thousands)	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)
December 31, 2013				
Impaired loans- Commercial construction	$ 2,193	Appraisal of collateral (1)	Appraisal adj.	0% to 0% (0%)
			Disposal costs (2)	-8% to -11% (-9%)
Impaired loans- Commercial mortgage	60	Appraisal of collateral (1)	Appraisal adj.	0% to 0% (0%)
			Disposal costs (2)	-7% to -21% (-12%)
Impaired loans- Residential mortgage	576	Appraisal of collateral (1)	Appraisal adj.	0% to 0% (0%)
			Disposal costs (2)	-8% to -8% (-8%)
Impaired loan total	$ 2,829			
Other real estate owned	$ 124		Disposal costs (2)	-5% to -5% (-5%)

(1) Fair value is generally determined through independent appraisals or sales contracts of the underlying collateral, which generally include various level 3 inputs which are not identifiable.

(2) Appraisals are adjusted by management for qualitative factors and disposal costs.

Impaired loans. Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of $7.2 million at June 30, 2014. Of this, $1.4 million had a specific valuation allowance of $300,000, leaving a fair value of $1.1 million as of June 30, 2014. In addition, DNB had $2.0 million in impaired loans that were partially charged down by $300,000, leaving $1.7 million at fair value as of June 30, 2014.

The total fair value of impaired loans at June 30, 2014 was $2.8 million.

Impaired loans had a carrying amount of $7.9 million at December 31, 2013. Of this, $2.1 million had a specific valuation allowance of $379,000, leaving a fair value of $1.7 million at December 31, 2013. In addition, DNB had $3.1 million in impaired loans that were partially charged down by $2.0 million, leaving $1.1 million at fair value as of December 31, 2013. The total fair value of impaired loans at December 31, 2013 was $2.8 million.

Other Real Estate Owned & other repossessed property. Other real estate owned (“OREO”) consists of properties acquired as a result of, or in-lieu-of, foreclosure. Properties or other assets are classified as OREO and other repossessed property are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying value or fair value, less estimated costs to sell. Costs relating to the development or improvement of the assets are capitalized and costs relating to holding the assets are charged to expense. DNB had $945,000 of such assets at June 30, 2014, $940,000 of which was OREO and $5,000 was in other repossessed property. DNB had $1.1 million of such assets at December 31, 2013, which consisted of $1.0 million in OREO and $73,000 in other

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repossessed property. Subsequent to the repossession of these assets, DNB did not write down the carrying values during the six month period ending June 30, 2014 or the six month period ending June 30, 2013.

DNB's policy is to recognize transfer between levels as of the actual date of the event or change in circumstances that caused the transfer. There were no transfers between Level 1 and 2 for the three and six months ended June 30, 2014.

Below is management's estimate of the fair value of all financial instruments, whether carried at cost or fair value on the Company's consolidated balance sheet. The carrying amounts and fair values of financial instruments at June 30, 2014 and December 31, 2013 are as follows:

	June 30, 2014				
(Dollars in thousands)	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$ 28,428	$ 28,428	$ 28,428	$ -	$ -
AFS investment securities	131,702	131,702	17	131,685	-
HTM investment securities	63,069	63,361	-	63,361	-
Restricted stock	2,820	2,820	-	2,820	-
Loans and leases, net of allowance	434,135	427,449	-	-	427,449
Accrued interest receivable	2,248	2,248	-	2,248	-
Financial liabilities					
Deposits:					
Non-interest-bearing deposits	116,989	116,989	-	116,989	-
Interest-bearing deposits:	371,367	371,367	-	371,367	-
Time	79,494	79,196	-	79,196	-
Brokered deposits	7,719	7,660	-	7,660	-
Repurchase agreements	23,939	23,939	-	23,939	-
FHLBP advances	10,000	10,801	-	10,801	-
Junior subordinated debentures and other borrowings	9,279	8,236	-	8,236	-
Accrued interest payable	355	355	-	355	-
Off-balance sheet instruments	-	-	-	-	-

	December 31, 2013				
(Dollars in thousands)	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$ 34,060	$ 34,060	$ 34,060	$ -	$ -
AFS investment securities	121,659	121,659	18	121,641	-
HTM investment securities	65,299	63,402	-	63,402	-
Restricted stock	2,903	2,903	-	2,903	-
Loans and leases, net of allowance	410,731	402,569	-	-	402,569
Accrued interest receivable	2,297	2,297	-	2,297	-
Financial liabilities					
Deposits:					
Non-interest-bearing deposits	101,853	101,853	-	101,853	-
Interest-bearing deposits:	361,352	361,352	-	361,352	-
Time	95,542	95,648	-	95,648	-
Repurchase agreements	19,854	19,854	-	19,854	-
FHLBP advances	10,000	11,057	-	11,057	-
Junior subordinated debentures and other borrowings	9,279	9,267	-	9,267	-
Accrued interest payable	376	376	-	376	-
Off-balance sheet instruments	-	-	-	-	-

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The specific estimation methods and assumptions used can have a substantial impact on the resulting fair values of financial instruments. Following is a brief summary of the significant assumptions, methods, and estimates used in estimating fair value.

Limitations Fair value estimates are made at a specific point in time, based on relevant market information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time DNB’s entire holdings of a particular financial instrument. Because no market exists for a significant portion of DNB’s financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Cash and Cash Equivalents, Accrued Interest Receivable and Accrued Interest Payable The carrying amounts for short-term investments (cash and cash equivalents) and accrued interest receivable and payable approximate fair value.

Investment Securities The fair value of investment securities are determined by an independent third party (“preparer”). The preparer’s evaluations are based on market data. They utilize evaluated pricing models that vary by asset and incorporate available trade, bid and other market information. For securities that do not trade on a daily basis, their evaluated pricing applications apply available information such as benchmarking and matrix pricing. The market inputs normally sought in the evaluation of securities include benchmark yields, reported trades, broker/dealer quotes (only obtained from market makers or broker/dealers recognized as market participants), issuer spreads, two-sided markets, benchmark securities, bid, offers and reference data. For certain securities additional inputs may be used or some market inputs may not be applicable. Inputs are prioritized differently on any given day based on market conditions.

U.S. Government agencies are evaluated and priced using multi dimensional relational models and option adjusted spreads. State and municipal securities are evaluated on a series of matrices including reported trades and material event notices. Mortgage backed securities are evaluated using matrix correlation to treasury or floating index benchmarks, prepayment speeds, monthly payment information and other benchmarks. Other investments are evaluated using a broker   quote based application, including quotes from issuers. The carrying amount of non-readily marketable equity securities approximates liquidation value.

Restricted Stock The carrying amount of restricted investment in Federal Home Loan Bank stock, Federal Reserve stock and ACBB stock approximates fair value, and considers the limited marketability of such securities.

Loans Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, commercial mortgages, residential mortgages, consumer and non-accrual loans. The fair value of performing loans is calculated by discounting expected cash flows using an estimated market discount rate. Expected cash flows include both contractual cash flows and prepayments of loan balances. Prepayments on consumer loans were determined using the median of estimates of securities dealers for mortgage-backed investment pools.

The estimated discount rate considers credit and interest rate risk inherent in the loan portfolios and other factors such as liquidity premiums and incremental servicing costs to an investor. Management has made estimates of fair value discount rates that it believes to be reasonable. However, because there is no market for many of these financial instruments, management has no basis to determine whether the fair value presented would be indicative of the value negotiated in an actual sale.

The fair value for non-accrual loans not based on fair value of collateral is derived through a discounted cash flow analysis, which includes the opportunity costs of carrying a non-performing asset. An estimated discount rate was used for these non-accrual loans, based on the probability of loss and the expected time to recovery.

Deposits The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate money market accounts, savings accounts, and interest checking accounts approximate their fair values at the reporting date. Fair values for fixed-rate CDs are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Federal Home Loan Bank of Pittsburgh advances The fair value of the FHLBP advances is obtained from the FHLB and is calculated by discounting contractual cash flows using an estimated interest rate based on the current rates available for debt of similar remaining maturities and collateral terms.

Repurchase agreements Fair value approximates the carrying value of such liabilities due to their short-term nature.

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Junior subordinated debentures The fair value for subordinated debentures is calculated using discounted cash flows based upon current market spreads to LIBOR for debt of similar remaining maturities and collateral terms.

Off-balance-sheet Instruments (Disclosed at Cost) Off-balance-sheet instruments are primarily comprised of loan commitments, which are generally priced at market at the time of funding. Fees on commitments to extend credit and stand-by letters of credit are deemed to be immaterial and these instruments are expected to be settled at face value or expire unused. It is impractical to assign any fair value to these instruments. At June 30, 2014, un-funded loan commitments totaled $103.5 million and stand-by letters of credit totaled $2.1 million. At December 31, 2013, un-funded loan commitments totaled $89.4 million and stand-by letters of credit totaled $1.5 million.

NOTE 11: STOCKHOLDERS' EQUITY

On August 4, 2011, DNB entered into a Securities Purchase Agreement with the Secretary of the Treasury, pursuant to which the Company issued and sold to the Treasury 13,000 shares of its Non-Cumulative Perpetual Preferred Stock, Series 2011A ("Series 2011A Preferred Stock"), having a liquidation preference of $1,000 per share for aggregate proceeds of $13,000,000. The Securities Purchase Agreement was entered into, and the Series 2011A Preferred Stock was issued, pursuant to the Treasury's Small Business Lending Fund program ("SBLF"), a $30 billion fund established under the Small Business Jobs Act of 2010, that encourages lending to small businesses by providing capital to qualified community banks with assets of less than $10 billion. Of the $13.0 million in aggregate proceeds, $11,879,000 was used to repurchase the outstanding cumulative perpetual preferred stock. The securities sold in this transaction were exempt from registration under Section 4(2) of the Securities Act of 1933, as amended, as a transaction by DNB not involving a public offering.

The Series 2011A Preferred Stock is entitled to receive non-cumulative dividends payable quarterly, on each January 1, April 1, July 1 and October 1, beginning October 1, 2011. The dividend rate, which is calculated on the aggregate Liquidation Amount, was initially set at 3.874% per annum, and was based upon the level of "Qualified Small Business Lending", or "QSBL" (as defined in the Securities Purchase Agreement) originated by the Company's wholly owned national bank subsidiary DNB First, N.A. (the "Bank"). The dividend rate for dividends beyond the initial period are based upon the "Percentage Change in Qualified Lending" (as defined in the Securities Purchase Agreement) between each dividend period and the "Baseline" QSBL level. Such dividend rate may vary from 1% per annum to 5% per annum for the second through tenth dividend periods depending on the volume of Qualified Small Business Lending the Bank will originate in future periods, and will be fixed at a rate between 1% per annum to 7% per annum and remain unchanged up to four and one-half years following the funding date (the eleventh through the first half of the nineteenth dividend periods). Because it is not feasible to predict the volume of Qualified Small Business Lending in future periods, it is not feasible to estimate specific future dividend rates under this formula. If the Series 2011A Preferred Stock remains outstanding for more than four-and-one-half years, the dividend rate will be fixed at 9%. Prior to that time, in general, the dividend rate decreases as the level of the Bank's Qualified Small Business Lending increases. Such dividends are not cumulative, but the Company may only declare and pay dividends on its common stock (or any other equity securities junior to the Series 2011A Preferred Stock) if it has declared and paid dividends for the current dividend period on the Series 2011A Preferred Stock, and will be subject to other restrictions on its ability to repurchase or redeem common stock and other securities. In addition, if (i) the Company has not timely declared and paid dividends on the Series 2011A Preferred Stock for six dividend periods or more, whether or not consecutive, and (ii) shares of Series 2011A Preferred Stock with an aggregate liquidation preference of at least $13,000,000 are still outstanding, the Treasury (or any successor holder of Series 2011A Preferred Stock) may designate two additional directors to be elected to the Company's Board of Directors. DNB paid an annual rate on the $13.0 million of Series 2011A Preferred Stock of 1.00% for the quarters ended June 30, 2014 and June 30, 2013.

As more completely described in the Certificate of Designation, holders of the Series 2011A Preferred Stock have the right to vote as a separate class on certain matters relating to the rights of holders of Series 2011A Preferred Stock and on certain corporate transactions. Except with respect to such matters and, if applicable, the election of the additional directors described above, the Series 2011A Preferred Stock does not have voting rights.

The Company may redeem the shares of Series 2011A Preferred Stock, in whole or in part, at any time at a redemption price equal to the sum of the Liquidation Amount per share and the per-share amount of any unpaid dividends for the then-current period, subject to any required prior approval by the Company's primary federal banking regulator.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

DNB Financial Corporation. (the “Corporation” or "DNB"), may from time to time make written or oral “forward-looking statements,” including statements contained in the Corporation’s filings with the Securities and Exchange Commission (including this Quarterly Report on Form 10-Q and the exhibits hereto and thereto), in its reports to stockholders and in other communications by the Corporation, which are made in good faith by the Corporation pursuant to the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995, the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended.

These forward-looking statements include statements with respect to the Corporation’s beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions, that are subject to significant risks and uncertainties, and are subject to change based on various factors (some of which are beyond the Corporation’s control). The words “may,” “could,” “should,” “would,”"will," “believe,” “anticipate,” “estimate,” “expect,” “intend,” “plan” and similar expressions are i identify forward-looking statements. The following factors, among others, could cause the Corporation’s financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements: the strength of the United States economy in general and the strength of the local economies in which the Corporation conducts operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System; the recent downgrade, and any future downgrades, in the credit rating of the U.S. Government and federal agencies; inflation, interest rate, market and monetary fluctuations; the timely development of and acceptance of new products and services of the Corporation and the perceived overall value of these products and services by users, including the features, pricing and quality compared to competitors’ products and services; the willingness of users to substitute competitors’ products and services for the Corporation’s products and services; the success of the Corporation in gaining regulatory approval of its products and services, when required; the impact of changes in laws and regulations applicable to financial institutions (including laws concerning taxes, banking, securities and insurance); technological changes; acquisitions; changes in consumer spending and saving habits; the nature, extent, and timing of governmental actions and reforms, including the rules of participation for the Small Business Lending Fund, the implementation of Basel III, which may be changed unilaterally and retroactively by legislative or regulatory actions; and the success of the Corporation at managing the risks involved in the foregoing.

The Corporation cautions that the foregoing list of important factors is not exclusive. Readers are also cautioned not to place undue reliance on these forward-looking statements, which reflect management’s analysis only as of the date of this report, even if subsequently made available by the Corporation on its website or otherwise. The Corporation does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Corporation to reflect events or circumstances occurring after the date of this report.

For a complete discussion of the assumptions, risks and uncertainties related to our business, you are encouraged to review our filings with the Securities and Exchange Commission, including this Form 10-Q, as well as any changes in risk factors or other risks that we may identify in our quarterly or other reports subsequently filed with the SEC.

DESCRIPTION OF DNB'S BUSINESS AND BUSINESS STRATEGY

DNB is a bank holding company whose bank subsidiary, DNB First, National Association (the “Bank”) is a nationally chartered commercial bank with trust powers, and a member of the FDIC. DNB provides a broad range of banking services to individual and corporate customers through its thirteen community offices located throughout Chester and Delaware Counties, Pennsylvania. DNB is a community banking organization that focuses its lending and other services on businesses and consumers in the local market area. DNB funds all these activities with retail and business deposits and borrowings. Through its DNB First Investment Management & Trust division, the Bank provides investment management and trust administration services to individuals and non-profit organizations. The Bank and its subsidiary, DNB Investments & Insurance, provide brokerage, retirement and insurance services.

DNB earns revenues and generates cash flows by lending funds to commercial and consumer customers in its marketplace. DNB generates its largest source of interest income through its lending function. A secondary source of interest income is DNB’s investment portfolio, which provides liquidity and cash flows for future lending needs.

In addition to interest earned on loans and investments, DNB earns revenues from fees it charges customers for non-lending services. These services include wealth management investment and trust services; brokerage, annuitiy and insurance services; cash management services; banking and ATM services; as well as safekeeping and other depository services.

To ensure we remain well positioned to meet the growing needs of our customers and communities and to meet the challenges of the 21st century, we've worked to build awareness of our full-service capabilities and ability to meet the needs of a wide range of customers. This served to not only retain our existing, customer base, but to position ourselves as an attractive financial institution on which younger individuals and families can build their dreams. To that end, DNB continues to make appropriate investments in all areas of our business, including people, technology, facilities and marketing.

Comprehensive 5-Year Plan. During the second quarter of 2013, management updated the 5-year strategic plan that was designed to reposition its balance sheet and improve core earnings. Through the plan, management will endeavor to expand its loan portfolio through new originations, increased loan participations, as well as strategic loan and lease receivable purchases. Management also plans to reduce the absolute level of borrowings with cash flows from existing loans and investments as well as from new deposit growth. A discussion on DNB’s Key Strategies follows below:

•Focus on penetrating existing markets to maximize profitability;

•Grow loans and diversify the mix;

•Improve asset quality;

•Focus on profitable customer segments;

•Grow and diversify non-interest income, primarily wealth management;

•Focus on reducing DNB’s cost of funds by changing DNB’s mix of deposits; and

•Focus on cost containment and improving operational efficiencies.

Strategic Plan Update. DNB's second quarter and first half year-over-year earnings comparisons, in part, reflect the investments we have made in new hires to drive revenue in future quarters, technology to enhance the company’s capabilities, and branch upgrades to accommodate increased business and provide a welcoming environment for customers. We are further streamlining our retail banking business line, and initiatives we’ve taken have contributed to the reduction in our funding cost and gains in consumer lending. We recently launched a mortgage banking division, and we expect traction in this area to accelerate in future periods. Our growing consumer service capability is complementing our traditional commercial banking business, which remains a strong focus. DNB's net interest margin was 3.36% for the second quarter of 2014 compared with 3.35% for the second quarter of 2013, reflecting relative margin stability despite the continuing pressures of a low-interest rate environment. DNB mitigated some of this pressure through interest expense management, the positive impact of carrying fewer non-performing assets, increased levels of demand deposits and careful management of borrowings. DNB's composite cost of funds for the three and six-month periods ended June 30, 2014 was 0.38% and 0.40%, compared to 0.49% and 0.52% for the same periods in 2013. Total loans and leases after allowance for credit losses grew 5.7% to $434.14 million at June 30, 2014 compared with $410.73 million at December 31, 2013. Loan totals in the first half of 2014 reflected growth in commercial real estate and consumer lending. Total deposits were $575.57 million at June 30, 2014, growing from $558.75 million at December 31, 2013, and $561.91 million at June 30, 2013. The Company continued to build lower-cost core deposits, which increased 5.4% to $488.36 million at June 30, 2014 compared with $463.21 million at December 31, 2013. In addition, wealth management continued to build total assets under care, which increased 16.7% to $158.7 million at June 30, 2014 compared with $135.9 million at June 30, 2013, reflecting consistent consecutive quarterly growth. Increased assets under care contributed to 7.86% growth in second quarter 2014 fee income from wealth management services compared with the second quarter of 2013.

Management has made a concerted effort to improve the measurement and tracking of business lines and overall corporate performance levels. Improved information systems have increased DNB's ability to track key indicators and enhance corporate performance levels. Better measurement against goals and objectives and increased accountability will be integral in attaining desired loan, deposit and fee income production.

MATERIAL CHALLENGES, RISKS AND OPPORTUNITIES

The following is a summary of material challenges, risks and opportunities DNB has faced during the six-month period ended June 30, 2014:

Interest Rate Risk Management. Interest rate risk is the exposure to adverse changes in net interest income due to changes in interest rates. DNB considers interest rate risk the predominant risk in terms of its potential impact on earnings. Interest rate risk can occur for any one or more of the following reasons: (a) assets and liabilities may mature or re-price at different times; (b) short-term or long-term market rates may change by different amounts; or (c) the remaining maturity of various assets or liabilities may shorten or lengthen as interest rates change.

The principal objective of the Bank’s interest rate risk management is to evaluate the interest rate risk included in certain on and off-balance sheet accounts, determine the level of risk appropriate given the Bank’s business strategy, operating environment, capital and liquidity requirements and performance objectives, and manage the risk consistent with management’s approved guidelines. Through such management, DNB seeks to reduce the vulnerability of its operations to changes in interest rates. The Bank’s Asset Liability Committee (the “ALCO”) is responsible for reviewing the Bank’s asset/liability policies and interest rate risk position and making decisions involving asset liability considerations. The ALCO meets on a monthly basis and reports trends and the Bank’s interest rate risk position to the Board of Directors. The extent of the movement of interest rates is an uncertainty that could have a negative impact on the earnings of the Bank.

The largest component of DNB’s total income is net interest income, and the majority of DNB’s financial instruments are comprised of interest rate-sensitive assets and liabilities with various terms and maturities. The primary objective of management is to maximize net interest income while minimizing interest rate risk. Interest rate risk is derived from timing differences in the re-pricing of assets and liabilities, loan prepayments, deposit withdrawals, and differences in lending and funding rates. The ALCO actively seeks to monitor and control the mix of interest rate-sensitive assets and interest rate-sensitive liabilities. One measure of interest rate risk is net interest income simulation analysis. The ALCO utilizes simulation analysis, whereby the model estimates the variance in net interest income with a change in interest rates of plus or minus 200 and 300 basis points in addition to four yield curve twists over a twelve-month period.

Liquidity and Market Risk Management Liquidity is the ability to meet current and future financial obligations. The Bank further defines liquidity as the ability to respond to deposit outflows as well as maintain flexibility to take advantage of lending and investment opportunities. The Bank’s primary sources of funds are operating earnings, deposits, repurchase agreements, principal and interest payments on loans, proceeds from loan sales, principal and interest payments on mortgage backed securities, sales of investment securities, and advances from the FHLB. The Bank uses the funds generated to support its lending and investment activities as well as any other demands for liquidity such as deposit outflows. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows, mortgage prepayments, loan and security sales and the exercise of call features are greatly influenced by general interest rates, economic conditions and competition.

The objective of DNB’s asset/liability management function is to maintain consistent growth in net interest income within DNB’s policy limits. This objective is accomplished through the management of liquidity and interest rate risk, as well as customer offerings of various loan and deposit products. DNB maintains adequate liquidity to meet daily funding requirements, anticipated deposit withdrawals, or asset opportunities in a timely manner. Liquidity is also necessary to meet obligations during unusual, extraordinary or adverse operating circumstances, while avoiding a significant loss or cost. DNB's foundation for liquidity is a stable deposit base as well as a marketable investment portfolio that provides cash flow through regular maturities or that can be used for collateral to secure funding in an emergency. As part of its liquidity management, DNB maintains assets, which comprise its primary liquidity (Federal funds sold, investments and cash and due from banks, less pledged securities).

Credit Risk Management. DNB defines credit risk as the risk of default by a customer or counter-party. The objective of DNB's credit risk management strategy is to quantify and manage credit risk on an aggregate portfolio basis as well as to limit the risk of loss resulting from an individual customer default. Credit risk is managed through a combination of underwriting, documentation and collection standards. DNB's credit risk management strategy calls for regular credit examinations and quarterly management reviews of large credit exposures and credits that are experiencing credit quality deterioration. DNB's loan review procedures provide assessments of the quality of underwriting, documentation, risk grading and charge-off procedures, as well as an assessment of the allowance for credit loss reserve analysis process.

Competition. In addition to the challenges related to the interest rate environment, community banks in Chester and Delaware Counties have been experiencing increased competition from large regional and international banks entering DNB's marketplace through mergers and acquisitions. Competition for loans and deposits may negatively affect DNB's net interest margin. To compensate for the increased competition, DNB has targeted customers who have been disenfranchised by these mergers. To attract these customers, DNB has introduced new products and services, such as Mobile Money and Mobile Deposit, Popmoney and instant issue debit cards.

Deposit Insurance Assessments. The deposits of the Bank are insured by the FDIC up to the limits set forth under applicable law and are subject to deposit insurance premium assessments. The FDIC imposes a risk based deposit premium assessment system, under which the amount of FDIC assessments paid by an individual insured depository institution, such as the

Bank, is based on the level of risk incurred in its activities. The FDIC places a depository institution in one of four risk categories determined by reference to its capital levels and supervisory ratings. In addition, in the case of those institutions in the lowest risk category, the FDIC further determines its assessment rates based on certain specified financial ratios. Pursuant to the Federal Deposit Insurance Act, the FDIC has authority and the responsibility to establish deposit insurance assessments at rates sufficient to maintain the designated reserve ratio of the Deposit Insurance Fund at a level between 1.15% and 1.5% of estimated insured deposits, and to take action to restore the designated reserve ratio to at least 1.15% of estimated insured deposits when it falls below that level. Effective as of April 1, 2011, the FDIC adopted changes to its base and risk-based deposit insurance rates. Pursuant to the new rules, a bank's annual assessment base rates were as follows, depending on the bank's risk category:

Initial and Total Base Assessment Rates*

	Risk Category				
	Risk Category I	Risk Category II	Risk Category III	Risk Category IV	Large and Highly Complex Institutions
Initial base assessment rate	5-9	14	23	35	5-35
Unsecured debt adjustment**	(4.5)-0	(5)-0	(5)-0	(5)-0	(5)-0
Brokered deposit adjustment	—	0-10	0-10	0-10	0-10
TOTAL BASE ASSESSMENT RATE	2.5-9	9-24	18-33	30-45	2.5-45

*Total base assessment rates do not include the depository institution debt adjustment.

**The unsecured debt adjustment cannot exceed the lesser of 5 basis points or 50 percent of an insured depository institution's initial base assessment rate; thus for example, an insured depository institution with an initial base assessment rate of 5 basis points will have a maximum unsecured debt adjustment of 2.5 basis points and cannot have a total base assessment rate lower than 2.5 basis points.

The Dodd-Frank Wall Street Reform and Consumer Protection Act, or Dodd-Frank Act, that was enacted by Congress on July 15, 2010, and was signed into law by President Obama on July 21, 2010, enacted a number of changes to the federal deposit insurance regime that affected the deposit insurance assessments the Bank is obligated to pay. For example:

-The law permanently raised the federal deposit insurance limit to $250,000 per account ownership. This change may have the effect of increasing losses to the FDIC insurance fund on failures of other insured depository institutions.

-The new law made deposit insurance coverage unlimited in amount for non-interest bearing transaction accounts until December 31, 2012. This change may also have the effect of increasing losses to the FDIC insurance fund on future failures of other insured depository institutions. Effective January 31, 2013, non-interest bearing transaction accounts fell under the existing FDIC insurance limit of $250,000 per account ownership.

-The law increased the insurance fund's minimum designated reserve ratio from 1.15 to 1.35, and removed the 1.50 cap on the reserve ratio. The law gave the FDIC discretion to suspend or limit the declaration or payment of dividends even when the reserve ratio exceeded the minimum designated reserve ratio.

The Dodd-Frank Act expanded the base for FDIC insurance assessments, requiring that assessments be based on the average consolidated total assets less tangible equity capital of a financial institution. On February 7, 2011, the FDIC approved a final rule to implement the foregoing provision of the Dodd-Frank Act and to make other changes to the deposit insurance assessment system applicable to insured depository institutions with over $10 billion in assets. Among other things, the final rule eliminated risk categories and the use of long-term debt issuer ratings in calculating risk-based assessments, and instead implemented a scorecard method, combining CAMELS ratings and certain forward-looking financial measures to assess the risk an institution poses to the Deposit Insurance Fund. The final rule also revised the assessment rate schedule for large institutions and highly complex institutions to provide assessments ranging from 2.5 to 45 basis points.

Each of these changes may increase the rate of FDIC insurance assessments to maintain or replenish the FDIC's deposit insurance fund. This could, in turn, raise the Bank's future deposit insurance assessment costs. On the other hand, the law changes the deposit insurance assessment base so that it will generally be equal to consolidated assets less tangible equity. This change of the assessment base from an emphasis on deposits to an emphasis on assets is generally considered likely to cause larger banking organizations to pay a disproportionately higher portion of future deposit insurance assessments, which may, correspondingly, lower the level of deposit insurance assessments that smaller community banks such as the Bank may otherwise have to pay in the future. On December 14, 2010, the FDIC issued a final rule setting the insurance fund's designated reserve ratio at 2, which is in excess of the 1.35 minimum designated reserve ratio established by the Dodd-Frank Act. While it is likely that the law will increase the Bank's future deposit insurance assessment costs, the specific amount by which the law's combined changes will affect the Bank's deposit insurance assessment costs is hard to predict, particularly because the law gives the FDIC enhanced discretion to set assessment rate levels.

In addition to deposit insurance assessments, banks are subject to assessments to pay the interest on Financing Corporation bonds. The Financing Corporation was created by Congress to issue bonds to finance the resolution of failed thrift institutions. The FDIC sets the Financing Corporation assessment rate every quarter. The current annual Financing Corporation assessment rate is 62 basis points on the deposit insurance assessment base, as defined above, which we anticipate will result in an aggregate estimated FICO assessment payment by the Bank of $36,500 in 2014.

Material Trends and Uncertainties. The global and U.S. economies have experienced reduced business activity as a result of disruptions in the financial system during the past five years. The United States, Europe and many other countries across the globe are struggling with too much debt and weaker streams of revenues as a result of recessionary pressures and high unemployment. Overall economic growth continues to be slow and national and regional unemployment rates remain at elevated levels. While the participation rate has decreased, the risks associated with our business remain acute in periods of slow economic growth and high unemployment. Moreover, financial institutions continue to be affected by a sluggish real estate market and constrained financial markets. While we are continuing to take steps to decrease and limit our exposure to problem loans, we nonetheless retain direct exposure to the residential and commercial real estate markets, and we are affected by these events.

The July 16, 2014 Beige Book indicated aggregate business activity in the Third Federal Reserve District (the "Third District"), the region DNB Financial is located, grew at a modest pace during the July 16, 2014 Beige Book period, with few changes from the June 4, 2014 Beige Book period. Auto sales continued at a very strong pace of growth. Service sectors maintained a moderate pace of growth overall, as did demand for transportation services. Non-auto retail sales and staffing services continued to rise at a modest pace, although there are signs that momentum is building for stronger growth in the remainder of the year. Manufacturers also reported an ongoing modest rate of increase in activity. Real estate sectors all reported slight overall growth for the July 16, 2014 Beige Book period. Lending volumes continued to grow slowly over this period, and credit quality continued to improve. Some contacts suggest that credit risks are rising with heated competition for loans. Overall, contacts reported slight increases in wages, home prices, and general price levels, similar to the June 4, 2014 Beige Book period.

Third District homebuilders reported little change in sales from the June 4, 2014 Beige Book period when a general malaise had dampened hopes for a strong spring season; however, construction has picked up. Residential real estate brokers reported slight improvements in sales in June, although May sales were still negative in most major markets on a year-over-year basis.

Nonresidential real estate contacts reported that growth in construction activity changed little from the slight pace seen in the June 4, 2014 Beige Book period. The growth of leasing activity dropped back to a slight pace from the more modest growth observed in the June 4, 2014 Beige Book period. However, construction activity is expected to accelerate throughout the second half of this year and the first half of 2015 because several major projects have recently broken ground and more will do so in the third quarter. The market for industrial/warehouse space remains strong throughout much of the Third District.

The overall outlook of the Third District's business contacts, many of which have business models similar to DNB's small business clients, is that they expect moderate growth over the next six months. Moreover, they generally expressed greater confidence in the underlying economy than in recent periods from their own perspective and from that of their consumer and business customers. About one-third of all firms reported plans to increase employment and to make additional capital expenditures over the next six months. For smaller businesses, such plans are likely to be realized on a very incremental basis.

Although DNB's earnings have been impacted by the general economic conditions, the impact has not been as severe as it has been in many parts of the nation, largely due to a relatively healthier economic climate in the Third Federal Reserve District and specifically Chester County. DNB's franchise spans both Chester and Delaware counties in southeastern Pennsylvania. The majority of loans have been made to businesses and individuals in Chester County and the majority of deposits are from businesses and individuals within the County. According to census data, Chester County's population has grown at approximately 15%, compared to 13% for the nation and 3% for the Commonwealth of Pennsylvania. The median household income in Chester County is $72,288 and the County ranks 14th nationally in disposable income. The unemployment rate for Chester County stood at 4.8% as of March 2014, compared to a Pennsylvania unemployment rate of 5.6% and a national unemployment rate of 6.8%. Traditionally, the unemployment rate has been the lowest in the surrounding five-county area and it ranks among the lowest unemployment rates in the Commonwealth. Chester County has a civilian labor force of 266,100, with manufacturing jobs representing 23.1% of the workforce and retail shopping comprising 13.8% of the total employment. During the last few years, the County has been able to keep most of its major employers, however some of them have downsized in order to remain competitive. Chester County is home to several Fortune 500 companies. Thirteen Chester County employers have 1,000 employees or more. Of these 13 companies, two companies have more than 5,000 employees.

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As the U.S. and local economy moves through a period of reduced business activity and historically high unemployment rates, delinquencies may rise as the value of homes decline and DNB's borrowers experience financial difficulty due to corporate downsizing, reduced sales, or other negative events which may impact their ability to meet their contractual loan payments. For the three months ended June 30, 2014, net income available to common shareholders was $1.09 million or $0.38 per diluted common share compared with $1.21 million or $0.44 per diluted common share for the three months ended June 30, 2013. For the six months ended June 30, 2014, net income available to common shareholders was $2.05 million or $0.73 per diluted common share compared with $2.35 million or $0.85 per diluted common share for the six months ended June 30, 2013.

These and other factors have impacted our operations. We continue to focus on the consistency and stability of core earnings and balance sheet strength which are critical success factors in today's challenging economic environment.

Regulatory Initiatives Related to Our Industry. The federal government continues to consider a variety of reforms related to banking and the financial industry including, without limitation, the Dodd-Frank Act. The Dodd-Frank Act is intended to promote financial stability in the U.S., reduce the risk of bailouts and protect against abusive financial services practices by improving accountability and transparency in the financial system and ending "too big to fail" institutions. It is the broadest overhaul of the U.S. financial system since the Great Depression, and although enacted more than five years ago, much of its impact will be determined by the scope and substance of many regulations that still need to be adopted by various regulatory agencies to implement its provisions. For these reasons, the overall impact on DNB and its subsidiaries remains unknown at this time.

The Dodd-Frank Act delegates to various federal agencies, including the Consumer Financial Protection Bureau, the task of implementing its many provisions through regulation. While some regulations have been adopted, hundreds of new federal regulations, studies and reports addressing all of the major areas of the new law, including the regulation of banks and their holding companies, will be required, ensuring that federal rules and policies in this area will be further developing for months and years to come. Based on the provisions of the Dodd-Frank Act and adopted and anticipated implementing regulations, it is highly likely that banks and thrifts as well as their holding companies will be subject to significantly increased regulation and compliance obligations.

The Dodd-Frank Act could require us to make material expenditures, in particular personnel training costs and additional compliance expenses, or otherwise adversely affect our business or financial results. It could also require us to change certain of our business practices, adversely affect our ability to pursue business opportunities we might otherwise consider engaging in, cause business disruptions and/or have other impacts that are as-of-yet unknown to DNB and the Bank. Failure to comply with these laws or regulations, even if inadvertent, could result in negative publicity, fines or additional licensing expenses, any of which could have an adverse effect on our cash flow and results of operations. For example, a provision of the Dodd-Frank Act precludes bank holding companies from treating future trust preferred securities issuances as Tier 1 capital for regulatory capital adequacy purposes. This provision may narrow the number of possible capital raising opportunities DNB and other bank holding companies might have in the future. Further, the new rules issued by the Consumer Financial Protection Bureau may materially affect the methods and costs of compliance by the Bank in connection with future consumer-related transactions.

New Capital Rules. On July 2, 2013, the Federal Reserve approved final rules that substantially amend the regulatory risk-based capital rules applicable to the Corporation and the Bank. The FDIC and the OCC have subsequently approved these rules. The final rules were adopted following the issuance of proposed rules by the Federal Reserve in June 2012, and implement the “Basel III” regulatory capital reforms and changes required by the Dodd-Frank Act. “Basel III” refers to two consultative documents released by the Basel Committee on Banking Supervision in December 2009, the rules text released in December 2010, and loss absorbency rules issued in January 2011, which include significant changes to bank capital, leverage and liquidity requirements.

The rules include new risk-based capital and leverage ratios, which will be phased in from 2015 to 2019, and will refine the definition of what constitutes “capital” for purposes of calculating those ratios. The new minimum capital level requirements applicable to the Corporation and the Bank under the final rules would be: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6% (increased from 4%); (iii) a total capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4% for all institutions. The final rules also establish a “capital conservation buffer” above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. The capital conservation buffer will be phased-in over four years beginning on January 1, 2016, as follows: the maximum buffer will be 0.625% of risk-weighted assets for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter. This will result in the following minimum ratios beginning in 2019: (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. Under the final rules, institutions are subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

The final rules implement revisions and clarifications consistent with Basel III regarding the various components of Tier 1 capital, including common equity, unrealized gains and losses, as well as certain instruments that will no longer qualify as Tier 1 capital, some of which will be phased out over time. However, the final rules provide that small depository institution holding companies with less than $15 billion in total assets as of December 31, 2009 (which includes the Corporation) will be able to permanently include non-qualifying instruments that were issued and included in Tier 1 or Tier 2 capital prior to May 19, 2010 in additional Tier 1 or Tier 2 capital until they redeem such instruments or until the instruments mature.

The final rules also contain revisions to the prompt corrective action framework, which is designed to place restrictions on insured depository institutions, including the Bank, if their capital levels begin to show signs of weakness. These revisions take effect January 1, 2015. Under the prompt corrective action requirements, which are designed to complement the capital conservation buffer, insured depository institutions will be required to meet the following increased capital level requirements in order to qualify as “well capitalized:” (i) a new common equity Tier 1 capital ratio of 6.5%; (ii) a Tier 1 capital ratio of 8% (increased from 6%); (iii) a total capital ratio of 10% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 5% (increased from 4%).

The final rules set forth certain changes for the calculation of risk-weighted assets, which we will be required to utilize beginning January 1, 2015. The standardized approach final rule utilizes an increased number of credit risk exposure categories and risk weights, and also addresses: (i) an alternative standard of creditworthiness consistent with Section 939A of the Dodd-Frank Act; (ii) revisions to recognition of credit risk mitigation; (iii) rules for risk weighting of equity exposures and past due loans; (iv) revised capital treatment for derivatives and repo-style transactions; and (v) disclosure requirements for top-tier banking organizations with $50 billion or more in total assets that are not subject to the “advance approach rules” that apply to banks with greater than $250 billion in consolidated assets. Based on our current capital composition and levels, we believe that we would be in compliance with the requirements as set forth in the final rules if they were presently in effect.

Other Material Challenges, Risks and Opportunities. As a financial institution, DNB's earnings are significantly affected by general business and economic conditions. These conditions include short-term and long-term interest rates, inflation, monetary supply, fluctuations in both debt and equity capital markets, and the strength of the United States economy and local economies in which we operate. As mentioned above in Material Trends and Uncertainties, the economic downturn, increased unemployment, and other events negatively impact household and/or corporate incomes and could decrease the demand for DNB's loan and non-loan products and services and increase the number of customers who fail to pay interest or principal on their loans. Geopolitical conditions can also affect DNB's earnings. Acts or threats of terrorism, actions taken by the United States or other governments in response to acts or threats of terrorism and our military conflicts, could impact business conditions in the United States.

CRITICAL ACCOUNTING POLICIES

The following discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with United States generally accepted accounting principals. Generally accepted accounting principles are complex and require management to apply significant judgment to various accounting, reporting and disclosure matters. Management must use assumptions and estimates to apply these principles where actual measurement is not possible or practical. Actual results may differ from these estimates under different assumptions or conditions.

In management's opinion, the most critical accounting policies and estimates impacting DNB's consolidated financial statements are listed below. These policies are critical because they are highly dependent upon subjective or complex judgments, assumptions and estimates. Changes in such estimates may have a significant impact on the financial statements. For a complete discussion of DNB's significant accounting policies, see the footnotes to the Consolidated Financial Statements included in DNB's 10-K for the year ended December 31, 2013.

Determination of the allowance for credit losses. Credit loss allowance policies involve significant judgments, estimates and assumptions by management which may have a material impact on the carrying value of net loans and leases and, potentially, on the net income recognized by DNB from period to period. The allowance for credit losses is based on management's ongoing evaluation of the loan and lease portfolio and reflects an amount considered by management to be its best estimate of the amount necessary to absorb known and inherent losses in the portfolio. Management considers a variety of factors when establishing the allowance, such as the impact of current economic conditions, diversification of the portfolios, delinquency statistics, results of loan review and related classifications, and historic loss rates. In addition, certain individual loans which management has identified as problematic are specifically provided for, based upon an evaluation of the borrower's perceived ability to pay, the estimated adequacy of the underlying collateral and other relevant factors. In addition, regulatory authorities, as an integral part of their examinations, periodically review the allowance for credit losses. They may require additions to the allowance based upon their judgments about information available to them at the time of examination. Although provisions have been established and segmented by type of loan, based upon management's assessment of their differing inherent loss characteristics, the entire allowance for credit losses is available to absorb further losses in any category.

Management uses significant estimates to determine the allowance for credit losses. Because the allowance for credit losses is dependent, to a great extent, on conditions that may be beyond DNB's control, management's estimate of the amount necessary to absorb credit losses and actual credit losses could differ. DNB's current judgment is that the allowance for credit losses remains

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appropriate at June 30, 2014. For a description of DNB's accounting policies in connection with its allowance for credit losses, see, "Allowance for Credit Losses", in Management's Discussion and Analysis.

Realization of deferred income tax items. Estimates of deferred tax assets and deferred tax liabilities make up the asset category titled "net deferred taxes". These estimates involve significant judgments and assumptions by management, which may have a material impact on the carrying value of net deferred tax assets for financial reporting purposes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis, as well as operating loss carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance would be established against deferred tax assets when in the judgment of management, it is more likely than not that such deferred tax assets will not become available. For a more detailed description of these items, refer to Note 11 (Federal Income Taxes) to DNB's consolidated financial statements for the year ended December 31, 2013.

The notes to DNB's most recent Consolidated Financial Statements as set forth in DNB's Annual Report 10-K identify other significant accounting policies used in the development and presentation of its financial statements. This discussion and analysis, the significant accounting policies, and other financial statement disclosures identify and address key variables and other qualitative and quantitative factors that are necessary for an understanding and evaluation of DNB and its results of operations.

FINANCIAL CONDITION

DNB's total assets were $685.2 million at June 30, 2014 compared to $661.5 million at December 31, 2013. The $23.7 million increase in total assets was primarily attributable to a $23.7 million increase in loans and leases before allowance for credit losses and a $7.8 million increase in investment securities, offset by a $5.6 million decrease in cash and cash equivalents, a $974,000 decrease in other assets and a $264,000 increase in the allowance for credit losses.

Investment Securities. Investment securities including restricted stock at June 30, 2014 were $197.6 million compared to $189.9 million at December 31, 2013. The $7.7 million increase in investment securities and restricted stock was primarily due to $44.9 million in sales, principal pay-downs, calls and maturities offset by a $1.7 million change in unrealized loss and the purchase of $51.2 million in investment securities.

Gross Loans and Leases. DNB's loans and leases increased $23.7 million to $439.0 million at June 30, 2014 compared to $415.4 million at December 31, 2013. Total commercial loans, consumer loans, and residential loans increased $17.8 million, $5.2 million and $660,000, respectively.

Deposits. Deposits were $575.6 million at June 30, 2014 compared to $558.7 million at December 31, 2013. Deposits increased $16.8 million or 3.01% during the six-month period ended June 30, 2014. Core deposits, which are comprised of demand, NOW, money markets and savings accounts, increased by $25.1 million and brokered deposits increased by $7.7 million while time deposits decreased by $16.0 million.

Borrowings. Borrowings were $43.7 million at June 30, 2014 compared to $39.7 million at December 31, 2013. The increase of $4.1 million or 10.3% was primarily due to a $4.1 million increase in repurchase agreements.

Stockholders’ Equity. Stockholders' equity was $61.7 million at June 30, 2014 compared to $58.6 million at December 31, 2013. The increase in stockholders’ equity was primarily a result of year-to-date earnings of $2.1 million and $1.1 million of accumulated other comprehensive income. These additions to stockholders equity were partially offset by $387,000 of dividends paid on DNB’s common stock and $65,000 of dividends paid on SBLF preferred stock. (See Note 11 in this form 10-Q regarding DNB's participation in the Treasury’s Small Business Lending Fund program (“SBLF”), a $30 billion fund established under the Small Business Jobs Act of 2010.)

RESULTS OF OPERATIONS

SUMMARY

Net income for the three and six-month periods ended June 30, 2014 was $1.1 million and $2.1 million compared to $1.3 million and $2.4 million for the same periods in 2013. Diluted earnings per share for the three and six-month periods ended June 30, 2014 were $0.38 and $0.73 compared to $0.44 and $0.85 for the same periods in 2013. The $130,000 decrease in net income during the most recent three-month period was attributable to a $402,000 increase in non-interest expense, a $45,000 decrease in non-interest income, and a $10,000 decrease in interest income, partially offset by $138,000 decrease in interest expense, a $120,000 decrease in provision for credit losses and a $69,000 decrease in tax expense. The $301,000 decrease during the six-month period was attributable to a $708,000 increase in non-interest expense, a $75,000 increase in the provision for credit losses, and a $25,000 decrease in non-interest income, offset by a $313,000 decrease in interest expense, a $176,000 decrease in income tax expense, and an $18,000 increase in interest income.

NET INTEREST INCOME

DNB's earnings performance is primarily dependent upon its level of net interest income, which is the excess of interest income over interest expense. Interest income includes interest earned on loans, investments and federal funds sold and interest-earning cash, as well as loan fees and dividend income earned on investment securities. Interest expense includes interest on deposits, Federal Home Loan Bank of Pittsburgh ("FHLBP") advances, repurchase agreements, Federal funds purchased and other borrowings.

Net interest income for the three and six-month periods ended June 30, 2014 was $5.3 million and $10.5 million compared to $5.2 million and $10.1 million for the same periods in 2013. Interest income for the three and six-month periods ended June 30, 2014 was $5.9 million and $11.7 million compared to $5.9 million and $11.7 million for the same periods in 2013. Interest expense for the three and six-month periods ended June 30, 2014 was $581,000 and $1.2 million compared to $719,000 and $1.5 million for the same periods in 2013. The composite cost of funds for the three and six-month periods ended June 30, 2014 was 0.38% and 0.40%, compared to 0.49% and 0.52% for the same periods in 2013. The net interest margin for the three and six-month periods ended June 30, 2014 was 3.36% and 3.36% compared to 3.35% and 3.34% for the same periods in 2013.

Interest on loans and leases was $4.9 million and $9.7 million for the three and six-month periods ended June 30, 2014, compared to $4.9 million and $9.7 million for the same periods in 2013. The average balance of loans and leases was $431.8 million with an average yield of 4.49% for the second quarter of 2014 compared to $395.6 million with an average yield of 4.92% for the same period in 2013. The average balance of loans and leases was $426.7 million with an average yield of 4.54% for the first six months of 2014 compared to $395.2 million with an average yield of 4.93% for the same period in 2013.

Interest and dividends on investment securities was $1.0 million and $2.0 million for the three and six-month periods ended June 30, 2014, compared to $995,000 and $1.9 million for the same periods in 2013. The average balance of investment securities was $192.4 million with a tax equivalent average yield of 2.29% for the second quarter of 2014 compared to $198.8 million with a tax equivalent average yield of 2.20% for the same period in 2013. The average balance of investment securities was $191.2 million with a tax equivalent average yield of 2.32% for the first six months of 2014 compared to $196.3 million with a tax equivalent average yield of 2.20% for the same period in 2013.

Interest on deposits was $331,000 and $709,000 for the three and six-month periods ended June 30, 2014, compared to $465,000 and $950,000 for the same periods in 2013. The average balance of deposits was $562.2 million with an average rate of 0.23% for the second quarter of 2014 compared to $551.2 million with an average rate of 0.34% for the same period in 2013. The average balance of deposits was $558.5 million with an average rate of 0.25% for the first six months of 2014 compared to $540.1 million with an average rate of 0.35% for the same period in 2013.

Interest on borrowings was $250,000 and $497,000 for the three and six-month periods ended June 30, 2014, compared to $254,000 and $569,000 for the same periods in 2013. The average balance of borrowings was $39.2 million with an average rate of 2.55% for the second quarter of 2014 compared to $42.1 million with an average rate of 2.42% for the same period in 2013. The average balance of borrowings was $39.4 million with an average rate of 2.54% for the first six months of 2014 compared to $45.9 million with an average rate of 2.50% for the same period in 2013.

PROVISION FOR CREDIT LOSSES

To provide for known and inherent losses in the loan and lease portfolios, DNB maintains an allowance for credit losses. Provisions for credit losses are charged against income to increase the allowance when necessary. Loan and lease losses are charged directly against the allowance and recoveries on previously charged-off loans and leases are added to the allowance. In establishing its allowance for credit losses, management considers the size and risk exposure of each segment of the loan and lease portfolio, past loss experience, present indicators of risk such as delinquency rates, levels of non-accruals, the potential for losses in future periods, and other relevant factors. Management’s evaluation of criticized and classified loans generally includes reviews of borrowers of $100,000 or greater. Consideration is also given to examinations performed by regulatory agencies, primarily the Office of the Comptroller of the Currency (“OCC”).

Management reviews and establishes the adequacy of the allowance for credit losses in accordance with U.S. generally accepted accounting principles, guidance provided by the Securities and Exchange Commission and as prescribed in OCC Bulletin 2006-47. Its methodology for assessing the appropriateness of the allowance consists of several key elements which include: specific allowances for identified impaired loans; and allowances by loan type for pooled homogenous loans. In considering national and local economic trends, we review a variety of information including Federal Reserve publications, general economic statistics, foreclosure rates and housing statistics published by third parties. We believe this improves the measure of inherent loss over a complete economic cycle and reduces the impact for qualitative adjustments. The unallocated portion of the allowance is intended to provide for probable losses not otherwise accounted for in management's other elements of its overall estimate. An unallocated component is maintained to cover uncertainties such as changes in the national and local economy, concentrations of credit, expansion into new markets and other factors that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

In addition, DNB reviews historical loss experience for the residential mortgage, commercial mortgage, commercial term, commercial construction, home equity and consumer installment loan pools to determine a historical loss factor. The historical loss factors are then applied to the current portfolio balances to determine the required reserve percentage for each loan pool. A historical loss ratio is determined for each group over a five year period. The five year average loss ratio by type is then used to calculate the estimated loss based on the current balance of each group. This five year time period is appropriate given DNB's historical level of losses and, more importantly, represents the current economic environment.

This analysis is intended to assess the potential for loss within the loan portfolio and to substantiate the adequacy of the allowance. Should the analysis indicate that the allowance is not adequate, management will recommend a provision expense be made in an amount equal to the shortfall derived. In establishing and reviewing the allowance for adequacy, emphasis has been placed on utilizing the methodology prescribed in OCC Bulletin 2006-47. Management believes that the following factors create a comprehensive system of controls in which management can monitor the quality of the loan portfolio. Consideration has been given to the following factors and variables which may influence the risk of loss within the loan portfolio:

•Changes in the nature and volume of the portfolio and in the terms of loans;

•Changes in the volume and severity of past due loans, the volume of non-accrual loans, and the volume and severity of adversely classified or graded loans;

•The existence and effect of any concentrations of credit, and changes in the level of such concentrations;

•Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses;

•Changes in the experience, ability, and depth of lending management and other relevant staff;

•Changes in the quality of the institution's loan review system;

•Changes in international, national, regional, and local economic and business conditions and developments that affect the collectability of the portfolio, including the condition of various market segments;

•The effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the institution's existing portfolio; and

•Changes in the value of underlying collateral for collateral dependent loans.

Portfolio risk includes the levels and trends in delinquencies, impaired loans, changes in the loan rating matrix and trends in volume and terms of loans. Management is satisfied with the stability of the past due and non-performing loans and believes there has been no further decline in the quality of the loan portfolio due to any trend in delinquent or adversely classified loans. In determining the adequacy of the allowance, management considered the deterioration of asset quality in DNB’s commercial mortgage and residential first mortgage portfolios, which were factors contributing to the increase in the level of allowance during 2012 and 2011. In addition to ordering new appraisals and creating specific reserves on impaired loans, the allowance allocation rates were increased, reflective of delinquency trends which have been caused by continued weakness in the housing markets, falling home equity values, and rising unemployment. New appraisal values we have obtained for existing loans have generally been consistent with trends indicated by Case-Schiller and other indices.

Given the contraction in real estate values, DNB closely monitors the loan to value ratios of all classified assets and requires periodic current appraisals to monitor underlying collateral values. Management also reviews borrower, sponsorship and guarantor’s financial strength along with their ability and willingness to provide financial support of their obligations on an immediate and continuing basis.

There was a $255,000 and a $630,000 provision made during the three and six months ended June 30, 2014, compared to $375,000 and $555,000 for the same periods in 2013. DNB’s percentage of allowance for credit losses to total loans and leases was

1.11% at June 30, 2014 compared to 1.11% and 1.72% at December 31, 2013 and June 30, 2013, respectively. Net charge-offs were $366,000, $4.7 million, and $703,000 during the six months ended June 30, 2014, year ended December 31, 2013, and six months ended June 30, 2013, respectively. The percentage of net charge-offs to total average loans and leases were 0.09%, 1.20%, and 0.18% for those same respective periods. Management believes that the allowance for credit losses is adequate, but continues to monitor it along with other performance metrics including those ratios related to non-performing loans and leases. Management is not aware of any potential problem loans, which were accruing and current at June 30, 2014, where serious doubt exists as to the ability of the borrower to comply with the present repayment terms and that would result in a significant loss to DNB. Non-performing loans decreased $562,000 during the six month period ended June 30, 2014. The ratio of the allowance for credit losses as a percentage of loans and leases was 1.11% at June 30, 2014 and 1.11% at December 31, 2013 and reflects management's estimate of the level of inherent losses in the portfolio, which has been impacted by a recessionary economy, continued high unemployment, a weakened housing market and deterioration in income-producing properties.

We typically establish a general valuation allowance on classified loans which are not individually impaired. In establishing the general valuation allowance, we segregate these loans by category. The categories used by DNB include "doubtful," "substandard," "special mention," "watch list" and "pass." For commercial mortgage, commercial and construction loans, the determination of the category for each loan is based on periodic reviews of each loan by our lending and credit officers as well as an independent, third-party consultant. The reviews include a consideration of such factors as recent payment history, current financial data, cash flow, financial projections, collateral evaluations, guarantor or sponsorship financial strength and current economic and business conditions. Categories for residential mortgage and consumer loans are determined through a similar review. Classification of a loan within a category is based on identified weaknesses that increase the credit risk of loss on the loan. Each category carries a loss factor for the allowance percentage to be assigned to the loans within that category. The allowance percentage, is determined based on inherent losses associated with each type of lending as determined through consideration of our loss history with each type of loan, trends in credit quality and collateral values, and an evaluation of current economic and business conditions.

We establish a general allowance on non-classified loans to recognize the inherent losses associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem loans. This general valuation allowance is determined by segregating the loans by loan category and assigning allowance percentages to each category. An evaluation of each category is made to determine the need to further segregate the loans within each category by type. For our residential mortgage and consumer loan portfolios, we identify similar characteristics throughout the portfolio including credit scores, loan-to-value ratios and collateral. For our commercial mortgage and construction loan portfolios, a further analysis is made in which we segregated the loans by type based on the purpose of the loan and the collateral properties securing the loan. Various risk factors for each type of loan are considered, including the impact of general economic and business conditions, collateral value trends, credit quality trends and historical loss experience.

As of June 30, 2014, DNB had $6.1 million of non-performing assets, which included $5.2 million of non-performing loans and $945,000 of OREO and other repossessed assets. This compares to $6.8 million of non-performaing assets at December 31, 2013 which included $5.7 million of non-performing or impaired loans and $1.1 million of OREO and other repossessed assets. Loans are reviewed for impairment in accordance with FASB ASC 310-10-35. Impaired loans can either be secured or unsecured, not including large groups of smaller balance loans that are collectively evaluated. Impairment is measured by the difference between the loan amount and the present value of the future cash flow discounted at the loan's effective interest rate. Management measures loans for impairment by using the fair value of collateral for collateral dependent loans. In general, management reduces the amount of the appraisal by the estimated cost of acquisition and disposition of the underlying collateral and compares that adjusted value with DNB's carrying value. DNB establishes a specific valuation allowance on impaired loans that have a collateral shortfall and/or statement cashflow shortfalls, including estimated costs to sell in comparison to the carrying value of the loan. Of the $7.2 million of impaired loans at June 30, 2014, $1.4 million had a valuation allowance of $300,000 and $5.8 million had no specific allowance. Of the $7.9 million of impaired loans at December 31, 2013, $2.1 million had a valuation allowance of $379,000 and $5.8 million had no specific allowance. For those impaired loans that management determined that no specific valuation allowance was necessary, management has reviewed the present value of the future cash flows or the appraisal for each loan and determined that there is no shortfall in the collateral. During the quarter ended June 30, 2014, DNB recognized $130,000 in total charge-offs, $119,000 of which related to impaired loans. An impaired loan may not represent an expected loss.

We typically order new third-party appraisals or collateral valuations when a loan becomes impaired or is transferred to Other Real Estate Owned ("OREO"). This is done within two weeks of a loan becoming impaired or a loan moving to OREO. It generally takes two to eight weeks to receive the appraisals, depending on the type of property being appraised. We recognize any provision or related charge-off within two weeks of receiving the appraisal after the appraisal has been reviewed by DNB. We generally order a new appraisal for all impaired real estate loans having a balance of $100,000 or higher, every twelve months, unless management determines more frequent appraisals are necessary. We use updated valuations when time constraints do not permit a full appraisal process, to reflect rapidly changing market conditions. Because appraisals and updated valuations utilize historical data in reaching valuation conclusions, the appraised or updated value may or may not reflect the actual sales price that we will receive at the time of sale. Management uses the qualitative factor “Changes in the value of underlying collateral for collateral-dependent loans” to calculate any required reserve to mitigate this risk.

Real estate appraisals typically include up to three approaches to value: the sales comparison approach, the income approach (for income-producing property) and the cost approach. Not all appraisals utilize all three approaches to value. Depending on the nature of the collateral and market conditions, the appraiser may emphasize one approach over another in determining the fair value of collateral.

Appraisals may also contain different estimates of value based on the level of occupancy or future improvements. “As-is” valuations represent an estimate of value based on current market conditions with no changes to the collateral’s use or condition. “As-stabilized” or “as-completed” valuations assume that the collateral is improved to a stated standard or achieves its highest and best use in terms of occupancy. “As-stabilized” valuations may be subject to a present value adjustment for market conditions or the schedule for improvements.

In connection with the valuation process, we will typically develop an exit strategy for the collateral by assessing overall market conditions, the current condition and use of the asset and its highest and best use. For most income-producing real estate, investors value most highly a stable income stream from the asset; consequently, we conduct a comparative evaluation to determine whether conducting a sale on an “as-is” basis or on an “as-stabilized” basis is most likely to produce the highest net realizable value and compare these values with the costs incurred and the holding period necessary to achieve the “as stabilized” value.

Our estimates of the net realizable value of collateral include a deduction for the expected costs to sell the collateral or such other deductions as deemed appropriate. For most real estate collateral, we apply a seven to ten percent deduction to the value of real estate collateral to determine its expected costs to sell the asset.

Analysis of Allowance for Credit Losses

(Dollars in thousands)

	Six Months Ended June 30, 2014	Year Ended December 31, 2013	Six Months Ended June 30, 2013
Beginning balance	$ 4,623	$ 6,838	$ 6,838
Provisions	630	2,530	555
Loans charged off:			
Residential mortgage	(100)	(183)	(184)
Commercial mortgage	(8)	(716)	(394)
Commercial:			
Commercial term	(18)	(247)	(222)
Commercial construction	(261)	(3,648)	-
Lease financing	-	(26)	(26)
Consumer:			
Home Equity	-	-	-
Other	(11)	(70)	(5)
Total charged off	(398)	(4,890)	(831)
Recoveries:			
Residential mortgage	5	80	70
Commercial mortgage	-	-	-
Commercial:			
Commercial term	2	5	5
Commercial construction	10	-	-
Lease financing	6	59	53
Consumer:			
Home Equity	-	-	-
Other	9	1	-
Total recoveries	32	145	128
Ending balance	$ 4,887	$ 4,623	$ 6,690
Reserve for unfunded loan commitments	$ 160	$ 143	$ 142

The following table sets forth the composition of DNB’s allowance for credit losses for the dates indicated.

Composition of Allowance for Credit Losses

(Dollars in thousands)

	June 30, 2014		December 31, 2013		June 30, 2013	
	Amount	Percent of Loan Type to Total Loans	Amount	Percent of Loan Type to Total Loans	Amount	Percent of Loan Type to Total Loans
Residential mortgage	$ 315	6 %	$ 285	6 %	$ 309	6 %
Commercial mortgage	2,131	57	2,010	56	3,110	58
Commercial:						
Commercial term	641	20	621	21	484	21
Commercial construction	1,019	5	1,033	5	2,004	4
Lease financing	-	-	-	-	-	-
Consumer:						
Home Equity	176	10	156	10	181	9
Other	98	2	78	2	80	2
Unallocated	507	-	440	-	522	-
Total	$ 4,887	100 %	$ 4,623	100 %	$ 6,690	100 %
Reserve for unfunded loan commitments	$ 160	-	$ 143	-	$ 142	—

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NON-INTEREST INCOME

Non-interest income includes service charges on deposit products; fees received in connection with the sale of non-depository products and services, including fiduciary and investment advisory services offered through DNB First Investment Management and Trust; securities brokerage products and services and insurance products and services offered through DNB Investments & Insurance; and other sources of income such as increases in the cash surrender value of Bank Owned Life Insurance ("BOLI"), net gains on sales of investment securities, SBA loans and OREO properties. In addition, DNB receives fees for cash management, remote capture, merchant services, debit cards, safe deposit box rentals and similar activities.

Non-interest income for the three and six-month periods ended June 30, 2014 was $1.1 million and $2.3 million compared to $1.2 million and $2.4 million for the same periods in 2013. The $45,000 decrease during the three months ended June 30, 2014 was mainly attributable to decreased gains on sales of investments of $53,000, decreased gains on sales of loans of $16,000, decreased service charges on deposits (primarily NSF fees) of $13,000. These decreases were offset by increases of $24,000 in wealth management fees primarily due to increased annuity and mutual fund fees and $14,000 in other fees. During the six months ended June 30, 2014, non-interest income decreased $25,000 over the same period in 2013. This decrease was primarily due to decreases in gains on sale of loans of $163,000 and service charges on deposits (primarily NSF fees) of $28,000, offset by increases of $123,000 in gains on sale of investments and $44,000 in wealth management fees, primarily due to increased assets under care resulting in additional recurring fee income.

NON-INTEREST EXPENSE

Non-interest expense for the three and six-month periods ended June 30, 2014 was $4.7 million and $9.4 million compared to $4.3 million and $8.7 million for the same periods in 2013. During the three months ended June 30, 2014, total non-interest expense increased by $402,000. The increase was primarily due to a $221,000 increase in salary and employee benefits related to the formation of a new Mortgage Banking division, a $77,000 increase in other expenses, a $52,000 increase in furniture and equipment, a $43,000 increase in professional and consulting, a $29,000 increase in occupancy, and a $29,000 increase in advertising and marketing, offset by a $38,000 decrease in FDIC insurance and a $17,000 decrease in loss on sale of OREO. During the six months ended June 30, 2014, total non-interest expense increased $708,000. The increase was primarily attributable to a $360,000 increase in salary and employee benefits related to the formation of the new Mortgage Banking division, a $129,000 increase in occupancy mainly attributable to snow removal costs and other expenses relating to the severe winter weather, a $106,000 increase in other expenses, a $99,000 increase in furniture and equipment, a $44,000 increase in professional and consulting, and a $24,000 increase in advertising and marketing, offset by a $31,000 decrease in FDIC insurance and a $21,000 decrease in loss on sale of OREO.

INCOME TAXES

Income tax expense for the three and six-month periods ended June 30, 2014 was $361,000 and $684,000 compared to $430,000 and $860,000 for the same periods in 2013. The effective tax rate for the three and six-month periods ended June 30, 2014 was 24.4% and 24.4% compared to 25.6% and 26.2% for the same periods in 2013. Income tax expense for each period differs from the amount determined at the statutory rate of 34.0% due to tax-exempt income on loans and investment securities, DNB's ownership of BOLI policies, and tax credits recognized on a low-income housing limited partnership.

ASSET QUALITY

Non-performing assets totaled $6.1 million at June 30, 2014 compared to $6.8 million at December 31, 2013 and $13.5 million at June 30, 2013. The significant drop in non-performing assets at June 30, 2014 from June 30, 2013 was due to $4.7 million in charge-offs related to non-performing loans, $3.1 million of loans moved to OREO and subsequently sold, and a $2.2 million loan placed back on accrual status. Total non-performing assets decreased $269,000 and $713,000 during the three and six months ended June 30, 2014.

The non-performing loans to total loans ratio is 1.18% at June 30, 2014, down from 1.38% at December 31, 2013 and down from 2.60% at June 30, 2013. The non-performing assets to total assets ratio decreased to 0.89% at June 30, 2014, down from 1.03% at December 31, 2013, and 2.02% at June 30, 2013. The allowance to non-performing loans and leases ratio increased to 94.6% at June 30, 2014 from 80.7% at December 31, 2013 and 65.9% at June 30, 2013. DNB continues to work diligently to improve asset quality by adhering to strict underwriting standards and improving lending policies and procedures. Non-performing assets have, and will continue to have, an impact on earnings; therefore management intends to continue working aggressively to reduce the level of such assets.

Non-performing assets are comprised of non-accrual loans and leases, loans and leases delinquent over ninety days and still accruing, as well as Other Real Estate Owned ("OREO") and other repossessed assets. Non-accrual loans and leases are loans and leases for which the accrual of interest ceases when the collection of principal or interest payments is determined to be doubtful by management. It is the policy of DNB to discontinue the accrual of interest when principal or interest payments are delinquent 90 days or more (unless the loan principal and interest are determined by management to be fully secured and in the process of collection), or earlier if considered prudent. Interest received on such loans is applied to the principal balance, or may, in some instances, be recognized as income on a cash basis. A non-accrual loan or lease may be restored to accrual status when management expects to collect all contractual principal and interest due and the borrower has demonstrated a sustained period of repayment performance in accordance with the contractual terms. OREO consists of real estate acquired by foreclosure or deed-in-lieu of foreclosure. Other repossessed assets are primarily assets from DNB’s commercial lease portfolio that were repossessed. OREO and other repossessed assets are carried at the lower of carrying value or estimated fair value, less estimated disposition costs. Any significant change in the level of non-performing assets is dependent, to a large extent, on the economic climate within DNB’s market area.

DNB’s Credit Policy Committee monitors the performance of the loan and lease portfolio to identify potential problem assets on a timely basis. Committee members meet to design, implement and review asset recovery strategies, which serve to maximize the recovery of each troubled asset. As of June 30, 2014, DNB had $21.0 million of substandard loans. Of the $21.0 million, $16.9 million are performing and are believed to require increased supervision and review; and may, depending on the economic environment and other factors, become non-performing assets in future periods. The amount of performing substandard loans at December 31, 2013 was $4.9 million. The majority of the loans are secured by commercial real estate, with lesser amounts being secured by residential real estate, inventory and receivables.

The following table sets forth those assets that are: (i) placed on non-accrual status, (ii) contractually delinquent by 90 days or more and still accruing, and (iii) OREO as a result of foreclosure or voluntary transfer to DNB as well as other repossessed assets. In addition, the table sets forth DNB's asset quality and allowance coverage ratios at the dates indicated:

Non-Performing Assets

(Dollars in thousands)

	June 30, 2014	December 31, 2013	June 30, 2013
Non-accrual loans:			
Residential mortgage	$ 1,734	$ 2,250	$ 2,265
Commercial mortgage	192	266	3,286
Commercial:			
Commercial term	-	-	-
Commercial construction	2,293	2,554	4,326
Lease financing	-	-	-
Consumer:			
Home Equity	346	434	60
Other	99	82	102
Total non-accrual loans	4,664	5,586	10,039
Loans 90 days past due and still accruing	501	141	106

Total non-performing loans	5,165	5,727	10,145
Other real estate owned & other repossessed property	945	1,096	3,325
Total non-performing assets	$ 6,110	$ 6,823	$ 13,470
Asset quality ratios:			
Non-performing loans to total loans	1.18 %	1.38 %	2.60 %
Non-performing assets to total assets	0.89	1.03	2.02
Allowance for credit losses to:			
Total loans and leases	1.11	1.11	1.72
Non-performing loans and leases	94.6	80.7	65.9

Included in the loan and lease portfolio are loans for which DNB has ceased the accrual of interest. If contractual interest income had been recorded on non-accrual loans, interest would have been increased as shown in the following table:

(Dollars in thousands)	Six Months Ended June 30, 2014	Year Ended December 31, 2013	Six Months Ended June 30, 2013
Interest income which would have been recorded under original terms	$ 232	$ 580	$ 378
Interest income recorded during the period	3	3	3
Net impact on interest income	$ 229	$ 577	$ 375

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As of June 30, 2014, DNB had one commercial mortgage classified as a TDR totaling $2,269,000, compared to one commercial mortgage classified as a TDR totaling $2,272,000 (the same loan) at December 31, 2013. The rate on this loan was modified and the terms of the loans were changed to interest only while the project was being built out. The loan was extended and there was no reduction of principal. The balance of the loan prior to modification was $2,272,000 and the balance after the modification was $2,272,000. During the six months ended June 30, 2014, there were no defaults on any terms of this loan.

As of June 30, 2014, DNB had one consumer home equity loan classified as a TDR totaling $102,000, compared to no such loans at December 31, 2013. The monthly payment on this loan was reduced for 36 months and the borrower will resume making contractual payments at the end of this period. The loan was extended and there was no reduction of principal. The balance of the loan prior to modification was $102,000 and the balance after the modification was $102,000. During the six months ended June 30, 2014, there were no defaults on any terms of this loan.

Impaired loans are measured for impairment using the fair value of the collateral for collateral dependent loans. Information regarding impaired loans is presented as follows:

(Dollars in thousands)	At and For the Six Months Ended June 30, 2014	At and For the Year Ended December 31, 2013	At and For the Six Months Ended June 30, 2013
Total recorded investment	$ 7,198	$ 7,858	$ 10,218
Impaired loans with a specific allowance	1,384	2,095	5,457
Impaired loans without a specific allowance	5,814	5,763	4,761
Average recorded investment	7,604	10,309	12,728
Specific allowance allocation	300	379	1,926
Total principal and interest collected	272	872	819
Interest income recorded	3	3	3

LIQUIDITY AND CAPITAL RESOURCES

Management maintains liquidity to meet depositors' needs for funds, to satisfy or fund loan commitments, and for other operating purposes. DNB's foundation for liquidity is a stable and loyal customer deposit base, cash and cash equivalents, and a marketable investment portfolio that provides periodic cash flow through regular maturities and amortization, or that can be used as collateral to secure funding. As part of its liquidity management, DNB maintains assets that comprise its primary liquidity, which totaled $99.3 million at June 30, 2014 compared to $107.7 million at December 31, 2013. Primary liquidity includes investments, Federal funds sold and cash and due from banks, less pledged securities. DNB also anticipates scheduled payments and prepayments on its loan and mortgage-backed securities portfolios.

In addition, DNB maintains borrowing arrangements with various correspondent banks, the Federal Home Loan Bank of Pittsburgh and the Federal Reserve Bank of Philadelphia to meet short-term liquidity needs. Through these relationships, DNB had available credit of approximately $256.8 million at June 30, 2014. As a member of the FHLB, we are eligible to borrow up to a specific credit limit which is determined by the amount of our residential mortgages, commercial mortgages and other loans that have been pledged as collateral. As of June 30, 2014, our Maximum Borrowing Capacity with the FHLB was $223.8 million. At June 30, 2014, DNB had borrowed $10.0 million and the FHLB had issued letters of credit, on DNB's behalf, totaling $20.0 million against its available credit lines. At June 30, 2014, we also had available $33.0 million of unsecured federal funds lines of credit with other financial institutions as well as $22.3 million of available short or long term funding through the Certificate of Deposit Account Registry Service (CDARS) program. Management believes that DNB has adequate resources to meet its short-term and long-term funding requirements.

On August 5, 2011, Standard & Poor's downgraded the credit rating of the U.S. Government and federal agencies, including the FHLB, from AAA to AA+, with a negative outlook. Any future downgrades in the credit ratings of the U.S. Government and the FHLB could likely increase the borrowing costs of the FHLB and possibly have a negative impact on its operations and long-term performance. It is possible this could have an adverse effect on the value of the Corporation's investment in FHLB stock.

At June 30, 2014, DNB had $103.5 million in un-funded loan commitments. Management anticipates these commitments will be funded by means of normal cash flows. Certificates of deposit greater than or equal to $100,000 scheduled to mature in one year or less from June 30, 2014 totaled $34.4 million. Management believes that the majority of such deposits will be reinvested with DNB and that certificates that are not renewed will be funded by a reduction in cash and cash equivalents or by pay-downs and maturities of loans and investments.

The Corporation and the Bank have each met the definition of "well capitalized" for regulatory purposes on June 30, 2014. The Bank's capital category is determined for the purposes of applying the bank regulators' "prompt corrective action" regulations and for determining levels of deposit insurance assessments and may not constitute an accurate representation of the Corporation's or the Bank's overall financial condition or prospects. The Corporation's capital exceeds the FRB's minimum leverage ratio requirements for bank holding companies (see additional discussion included in Footnote 16 of DNB's December 31, 2013 Form 10-K).

Under federal banking laws and regulations, DNB and the Bank are required to maintain minimum capital as determined by certain regulatory ratios. Capital adequacy for regulatory purposes, and the capital category assigned to an institution by its regulators, may be determinative of an institution's overall financial condition.

The following table summarizes data and ratios pertaining to the Corporation and the Bank's capital structure.

	Actual			For Capital Adequacy Purposes			To Be Well Capitalized Under Prompt Corrective Action Provisions		
(Dollars in thousands)	Amount	Ratio		Amount	Ratio		Amount	Ratio	
DNB Financial Corporation									
June 30, 2014									
Total risk-based capital	$ 76,905	15.9	%	$ 38,634	8.0	%	N/A	N/A	
Tier 1 risk-based capital	71,858	14.9		19,317	4.0		N/A	N/A	
Tier 1 (leverage) capital	71,858	10.8		26,716	4.0		N/A	N/A	
December 31, 2013									
Total risk-based capital	$ 74,505	16.4	%	$ 36,338	8.0	%	N/A	N/A	
Tier 1 risk-based capital	69,727	15.4		18,169	4.0		N/A	N/A	
Tier 1 (leverage) capital	69,727	10.6		26,295	4.0		N/A	N/A	
DNB First, N.A.									
June 30, 2014									
Total risk-based capital	$ 76,900	15.9	%	$ 38,601	8.0	%	$ 48,252	10.0	%
Tier 1 risk-based capital	71,853	14.9		19,301	4.0		28,951	6.0	
Tier 1 (leverage) capital	71,853	10.8		26,698	4.0		33,373	5.0	
December 31, 2013									
Total risk-based capital	$ 74,527	16.4	%	$ 36,306	8.0	%	$ 45,381	10.0	%
Tier 1 risk-based capital	69,749	15.4		18,152	4.0		27,229	6.0	
Tier 1 (leverage) capital	69,749	10.6		26,314	4.0		32,893	5.0	

In addition, the Federal Reserve Bank (the "FRB") leverage ratio rules require bank holding companies to maintain a minimum level of "primary capital" to total assets of 5.5% and a minimum level of "total capital" to total assets of 6%. For this purpose, (i) "primary capital" includes, among other items, common stock, certain perpetual debt instruments such as eligible Trust preferred securities, contingency and other capital reserves, and the allowance for loan losses, (ii) "total capital" includes, among other things, certain subordinated debt, and "total assets" is increased by the allowance for loan losses. DNB's primary capital ratio and its total capital ratio are both well in excess of FRB requirements.

REGULATORY MATTERS

Dividends payable to the Corporation by the Bank are subject to certain regulatory limitations. Under normal circumstances, the payment of dividends in any year without regulatory permission is limited to the net profits (as defined for regulatory purposes) for that year, plus the retained net profits for the preceding two calendar years.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

To measure the impacts of longer-term asset and liability mismatches beyond two years, DNB utilizes an Economic Value of Equity ("EVE") model. The EVE model measures the potential price risk of equity to changes in interest rates and factors in the optionality included on the balance sheet. EVE analysis is used to dynamically model the present value of asset and liability cash flows, with rates ranging up or down 200 basis points. The EVE is likely to be different if rates change. Results falling outside prescribed ranges may require action by management. At June 30, 2014 and December 31, 2013, DNB's variance in the EVE as a percentage of assets with an instantaneous and sustained parallel shift of 200 basis points was within its negative 3% guideline, as shown in the following table. The change as a percentage of the present value of equity with a 200 basis point increase was within DNB's negative 25% guideline at June 30, 2014 and December 31, 2013.

(Dollars in thousands)	June 30, 2014			December 31, 2013		
Change in rates	Flat	-200bp	+200bp	Flat	-200bp	+200bp
EVE	$ 80,653	$ 80,162	$ 69,614	$ 71,853	$ 73,065	$ 62,246
Change		(491)	(11,039)		1,212	(9,607)
Change as % of assets		(0.1%)	(1.6%)		0.2%	(1.5%)
Change as % of PV equity		(0.6%)	(13.7%)		1.7%	(13.4%)

ITEM 4- CONTROLS AND PROCEDURES

DNB’s Management, with the participation of our Chief Executive Officer and Chief Financial Officer, has reviewed and evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of June 30, 2014, the end of the period covered by this report, in accordance with the requirements of Exchange Act Rule 240.13a-15(b). Based on that evaluation, Management has concluded that DNB’s current disclosure controls and procedures are effective.

Management of DNB is responsible for establishing and maintaining adequate internal control over financial reporting for DNB, as such term is defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. There was no change in DNB’s “internal control over financial reporting” (as such term is defined in Rule 13a-15(f) under the Exchange Act) that occurred during the fiscal quarter ended June 30, 2014, that has materially affected, or is reasonably likely to materially affect, DNB’s internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Neither DNB nor any of its subsidiaries is a party to, nor is any of their property the subject of, any material legal proceedings other than ordinary routine litigation incident to their businesses.

ITEM 1A. RISK FACTORS

Not applicable

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

There were no unregistered sales of equity securities during the quarter ended June 30, 2014. The following table provides information on repurchases by DNB of its common stock in each month of the quarter ended June 30, 2014:

Period	Total Number Of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (a)
April 1, 2014 – April 30, 2014	-	$ -	-	$ 63,016
May 1, 2014 – May 31, 2014	-	-	-	$ 63,016
June 1, 2014 – June 30, 2014	-	-	-	$ 63,016
Total	-	$ -	-	$ 63,016

On July 25, 2001, DNB authorized the buyback of up to 175,000 shares of its common stock over an indefinite period. On August 27, 2004, DNB increased the buyback from 175,000 to 325,000 shares of its common stock over an indefinite period.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

a) The following exhibits are filed or furnished herewith:

Exhibit Number	Description
3.1	Amended and Restated Articles of Incorporation, as amended effective December 8, 2008, filed March 31, 2009 as item 3(i) to Form 10-K for the fiscal year-ended December 31, 2008 (No. 1-34242) and incorporated herein by reference.
3.2	Bylaws of the Registrant as amended December 8, 2008, filed March 31, 2009 as item 3(ii) to Form 10-K for the fiscal year-ended December 31, 2008 (No. 1-34242) and incorporated herein by reference.
3.3	Certificate of Designations of Fixed Rate Cumulative Preferred Stock, Series 2008A of DNB Financial Corporation, filed as Exhibit 4.3 to Form 8-K (No. 1-34242) on January 26, 2009 and incorporated herein by reference.
10.1	Change of Control Agreement among DNB Financial Corporation, DNB First, N.A. and Vincent Liuzzi, filed herewith.
31.1	Rule 13a-14(a)/15d-14 (a) Certification of Chief Executive Officer
31.2	Rule 13a-14(a)/15d-14 (a) Certification of Chief Financial Officer
32.1	Section 1350 Certification of Chief Executive Officer

32.2	Section 1350 Certification of Chief Financial Officer
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

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

overmber

		DNB FINANCIAL CORPORATION
August 11, 2014	BY:	/s/ William S. Latoff
		William S. Latoff, Chairman of the
		Board and Chief Executive Officer
August 11, 2014	BY:	/s/ Gerald F. Sopp
		Gerald F. Sopp, Chief Financial Officer and Executive Vice President

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101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document