

Your Key

To Progress



First Keystone Corporation
2012 Annual Report

FINANCIAL HIGHLIGHTS

(Amounts in thousands, except per share)

	2012	2011	2010	2009	2008
SUMMARY OF OPERATIONS					
Interest income	\$ 34,936	\$ 37,028	\$ 38,154	\$ 37,726	\$ 37,638
Interest expense	6,514	9,405	12,742	15,565	18,116
Net interest income	28,422	27,623	25,412	22,161	19,522
Provision for loan losses	1,600	1,900	2,575	800	700
Investment securities gains (losses)-net	813	111	163	(138)	(148)
Net income	10,170	9,907	8,961	7,937	7,551

PER COMMON SHARE DATA

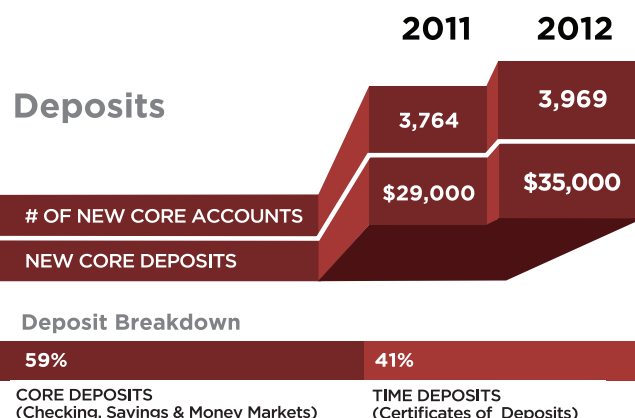
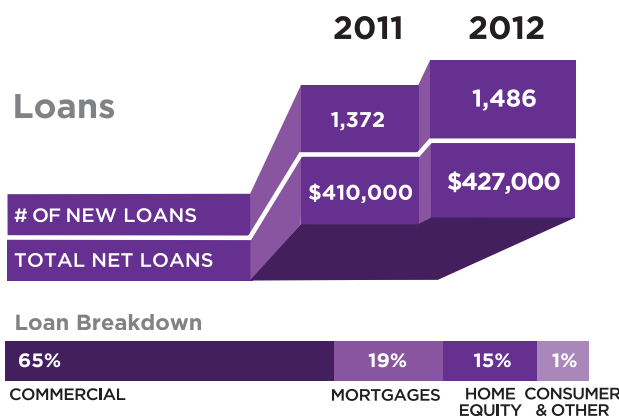
Net income	\$ 1.86	\$ 1.82	\$ 1.65	\$ 1.46	\$ 1.39
Cash dividends	1.01	.97	.93	.92	.89

BALANCE SHEET DATA

Assets	\$819,966	\$818,546	\$796,601	\$758,330	\$714,898
Investment securities	303,756	336,618	316,531	282,798	243,165
Net loans	427,124	410,066	403,950	401,375	403,172
Deposits	608,834	624,349	626,895	580,569	504,633
Stockholders' equity	103,330	93,092	79,060	74,167	69,147

PERFORMANCE RATIOS

Return on average assets	1.25%	1.21%	1.09%	1.06%	1.08%
Return on average equity	10.19%	11.57%	10.98%	10.88%	10.72%
Dividend payout ratio	54.18%	53.31%	56.47%	63.06%	64.12%
Average equity to average assets ratio	12.28%	10.43%	9.95%	9.73%	10.00%



New Initiatives

- Restructured Mortgage Lending Process
- Instituted All Star Employee Program
- Launched New Financial Services Referral Program

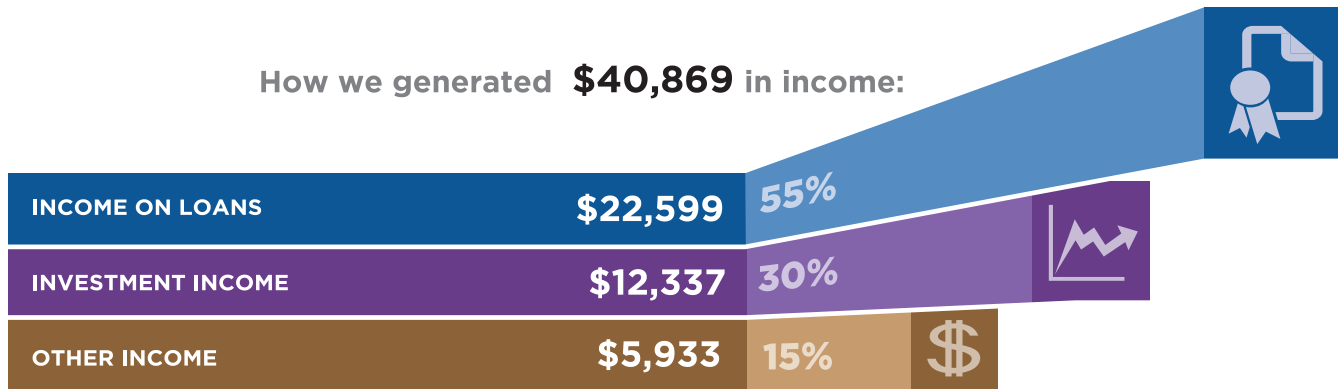
Community Offices

- Plymouth Celebrated One Year Anniversary
- Built & Relocated New Kingston Office

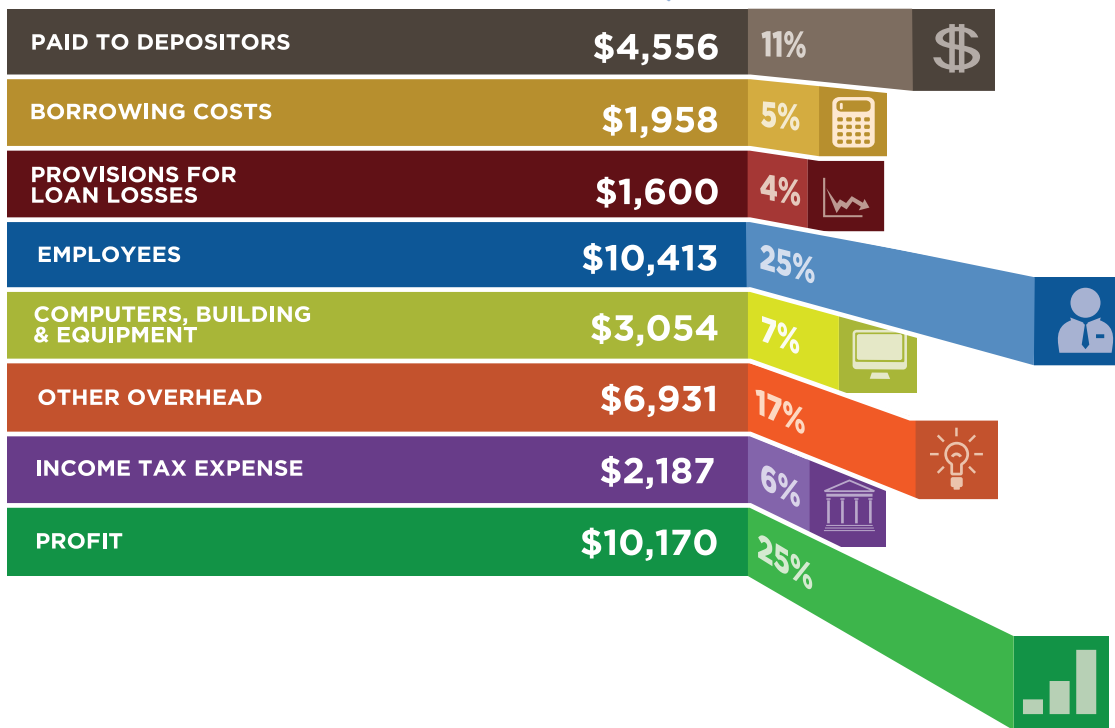
\$ Amounts in thousands

Income Statement in Graphic Form

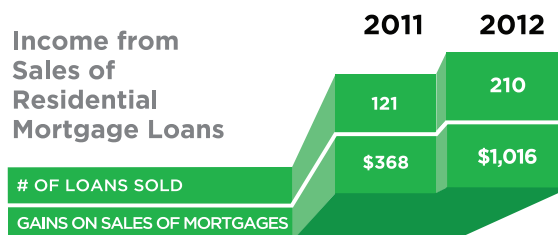
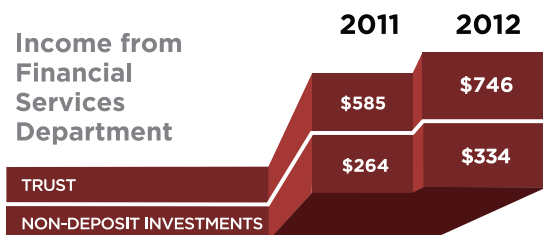
How we generated **\$40,869** in income:



How we used our **\$40,869** in income:



Components of Other Income



\$ Amounts in thousands

TO OUR SHAREHOLDERS

The cover of this year's Annual Report to Shareholders shows a picture of our new Kingston Office. Opened at the end of August 2012, this relocated branch is just one sign of the progress First Keystone Corporation is making on behalf of its customers and shareholders. In the 6 months since we re-opened our Kingston Office, the dedicated staff has grown deposits there by more than \$6.4 million or 19%. The addition of a dedicated Mortgage Consultant, Leona Luongo, to our Kingston office provides our customers with a seasoned professional to help with all of their mortgage borrowing needs.

By the time you will read this, we will have opened our 17th community office in Dallas, Pennsylvania. Located at 2325 Memorial Highway, the branch will provide our full range of banking services to an important new community. Martin Leandri was hired to lead the banking team in Dallas. Marty is a very motivated and accomplished banker and we are excited to have him on our team. He brings a wealth of banking experience and knowledge to the market. We have also hired Daniel Fuhr to assist the Bank's customers with retirement and financial planning throughout the Wyoming Valley.

Our new Administrative Offices in Berwick are slated to be open in early April 2013. This building will house all loan and deposit operations of the Corporation. The Financial Services Division will be front and center on the first floor for better customer convenience. Also located on the first floor will be the Commercial Lending Group. The complete remodel of our Main banking office, including the lobby renovation, will be completed in May 2013.

As you will note from the Infographic on the bottom of Page 1, income from the Sales of Residential Mortgages increased significantly in 2012, by \$648,000. This is due to a restructured mortgage lending process. We have identified a Mortgage Consultant in each of our regions: Greater Columbia County; Wyoming Valley and the Poconos, who can serve as experts in the mortgage lending process. We have streamlined back-office operations to focus on delivering the quickest turnaround time for mortgage loans in our market areas. These changes have allowed us to make a greater number of loans at a significantly higher profit to the Bank. This is another sign of the progress we are making at First Keystone Corporation.

Financial Highlights

For the year 2012, the Corporation had net income of \$10,170,000 as compared to \$9,907,000 in 2011, an increase in of 2.7%. Due to continued low interest rates courtesy of the Federal Reserve, our cost of funds declined significantly for the second straight year. This resulted in net interest income, our largest revenue source, increasing to \$28,422,000 in 2012 from \$27,623,000 in 2011, an increase of 2.9%. Non-interest income increased from \$4,431,000 in 2011 to \$5,933,000, or 33.9% on the strength of increased secondary market



residential mortgage sales and higher Trust Department income. Net income per share increased to \$1.86 from \$1.82, up 2.2%.

Assets at December 31, 2012 were essentially the same at year-end 2011, coming in at \$819,966,000. The investment portfolio was reduced by nearly \$33 million during the year. This was due to regular maturities and principal repayments in the portfolio, along with the fact that fewer productive investment opportunities were available due to falling interest rates. Net loans grew by 4.2% to end the year at \$427,124,000. Deposits fell from \$624,349,000 to \$608,834,000. This was primarily due to the loss of one large municipal depositor.

Short-term borrowings increased at the end of 2012 totaling \$55,069,000 at December 31st. This is an increase from \$30,882,000 from December 31, 2011. Long-term borrowings fell from \$64,339,000 to \$44,520,000. During the year, the Bank prepaid a portion of its long-term borrowings which were at higher than market rates incurring paid pre-payment penalties. These penalties were offset by the sales of investment securities at a net gain. The result of the transaction was increased net interest income, lower leverage ratios and reduced sensitivity to rising interest rates.

Total shareholders' equity increased to \$103,330,000 in 2012, up 11.0% over 2011. The largest portion of the increase, \$4,771,000, resulted from the increased value of our investment portfolio. As long-term interest rates fell during the year, the value of our fixed rate bonds increased. In addition, the Corporation retained \$4,660,000 in profits which were not paid out as dividends.

Our strong earnings have allowed us to raise the dividend again this year, to \$0.26 in the 4th quarter. During 2012 we paid dividends totaling \$1.01. That compares favorably to the \$0.97 paid in 2011. Based on the total 2012 dividend of \$1.01 and the December 31, 2012 share price of \$24.30, our dividend yield was 4.2%.

The cover of this report states: Your Key.....to Progress. 2012 has been a year of progress for First Keystone Corporation. From new branch development to the redesign of the Mortgage Lending process, your company has progressed in strength and profitability. By providing knowledgeable advice, exceptional service and cost effective solutions, our goal is to help our customers' progress in the same way.

From the Directors, senior management and all the employees, we thank you for your continued support of First Keystone during the past year.



Matthew P. Prosseda
President & Chief Executive Officer

United with our Communities

In the year 1864, Mordecai William Jackson, President of the First National Bank of Berwick, proudly looked upon his fledgling bank with grand hopes for the future. There's no doubt that words like 'progress' and 'change' entered his thoughts, but the one word that was certainly on his mind was 'community.' Mordecai could not have envisioned 16 beautiful community offices, covering four counties, all providing the same excellent customer service as his very first office.

Fast forward to 2012 and this same financial institution continues to grow and prosper while retaining its focus on the communities it serves. After 148 years, the Bank continues to balance the growing demand for services like online banking, mobile banking, and check imaging with the recognition that customer service and local connections are what sets it apart from competitors, both large and small. "Yesterday's Traditions. Tomorrow's Vision." is not just our tagline at First Keystone Community Bank, it's our way of life.



Kingston Staff - August 2012

In July, First Keystone Community Bank relocated its ten-year-old Kingston Office to a more convenient location with a new state-of-the-art facility, continuing to bring to this market a hometown alternative to the less personal, and much larger regional banks. The office features a sleek, modern look but retained the same friendly, helpful staff and an extensive menu of banking products. The Bank also made substantial renovations to its Nescopeck and Salem Township locations, renewing its commitment to those communities.

Perhaps the most important element of First Keystone's dedication is the support provided to many of the communities where we live and work. The Bank is particularly proud of several noteworthy highlights from the past year. First Keystone Community Bank provided significant financial and employee resource assistance to all United Way chapters where we reside. The employees actively participated in Berwick's "Riverfest" in October, "Relay for Life" in June; the Plymouth Kielbasa Festival and Nescopeck Community Days in August;

and hosted community members for “Christmas in Kingston”, a local business venture developed to promote neighborly goodwill.

What started out as a single 16’ x 25’ building has developed into a network of 16 full-service branches, dedicated to helping local people and businesses navigate the ever-changing financial landscape. It’s impossible to gauge Mordecai Jackson’s response to the Bank’s plans for 2013, (including new offices in Dallas, Shickshinny and opening a new operations center in downtown Berwick), one thing is certain: by leveraging the need for growth and prosperity with a continuing focus on serving the needs of its customers, First Keystone Community Bank will be part of its local communities for another 150 years.



Employees participating in Berwick Riverfest.



Employees, Liz Thomas & Paulette Zavislak man the booth at the Plymouth Kielbasa Festival, August 24 & 25, 2012.



Main, Freas, Nescopeck, Salem employees and kids participate in Nescopeck Community Days.

FIRST KEYSTONE CORPORATION

BOARD OF DIRECTORS



Robert E. Bull,
Chairman

*Retired Attorney
Bull, Bull & McDonald, LLP*



J. Gerald Bazewicz
Vice Chairman

*Retired President & CEO
First Keystone Community Bank*



John Arndt

*Owner
Arndt Insurance Agency*



Don E. Bower

*President
Don E. Bower, Inc.*



Robert A. Bull

*Attorney
Bull, Bull & McDonald, LLP*



Dr. Joseph B. Conahan, Jr.

*Ophthalmologist & Managing
Partner, Pocono Ambulatory
Surgery Center*



Jerome F. Fabian

*Owner & President
Tile Distributors of
America, Inc.*



John G. Gerlach

*Retired President
First Keystone Community Bank
Pocono Division*



Matthew P. Prosseda

*President & CEO
First Keystone Community Bank*



David R. Saracino

*Retired Vice President & CFO
First Keystone Community Bank*

OFFICERS

Robert E. Bull
Chairman

J. Gerald Bazewicz
Vice Chairman

Matthew P. Prosseda
President & Chief Executive Officer

Diane C.A. Rosler
Chief Financial Officer

John Arndt
Secretary

Cheryl L. Wynings
Assistant Secretary

FIRST KEYSTONE COMMUNITY BANK

OFFICERS

Robert E. Bull

Chairman of the Board

J. Gerald Bazewicz

Vice Chairman

John Arndt

Secretary

Executive Management

Matthew P. Prosseda

President

& Chief Executive Officer

Kevin L. Miller

Chief Operating Officer

Executive Vice President

Elaine A. Woodland

Director of Lending

Executive Vice President

Mark J. McDonald

Chief Credit Officer

Senior Vice President

Barbara J. Robbins

Deposit Operations Manager

Senior Vice President

Diane C. A. Rosler

Chief Financial Officer

Senior Vice President

& Cashier

Advisory Boards

BLOOMSBURG/DANVILLE

Michael E. Boone

Walter Deacon

Tim Flick

Dan W. Hartman

Michael H. Kuziak

Nancy Marr

Michael Nardone

WYOMING VALLEY

Timothy Connolly

Daniel Fierman

Michael Jezewski

James Mangan

Stephen Phillips

David Rodeghiero

POCONO COMMUNITY

Charles M. Hannig

Richard L. Price, Jr.

William E. Rinehart

Joel D. Rossi

Jacob E. Seip, Jr.

Gabriel D. Alessi - Vice President, Mortgage Services Manager

Jodi L. Alley - Vice President, Loan Operations Manager

Lesa A. Angell - Vice President, Retail Banking & Marketing Officer

John J. Babskie - Assistant Cashier, Community Office Manager

Wendy L. Bacher - Assistant Trust Officer, IRA Manager

Charlotte M. Bishop - Assistant Vice President, In Store Sales Manager

Patricia Buccieri - Assistant Vice President, Asst. Community Office Manager

Leighton Bull - Assistant Cashier, Mortgage Consultant

Carmelita A. Cleaver - Vice President, Retail Operations Officer

Sandra L. Cole - Assistant Cashier, Asst. Community Office Manager

Beverly A. Cruikshank - Vice President, Community Office Manager

Marcia H. Dobey - Assistant Cashier, Mortgage Underwriter-Processor

Andrew S. Faytko - Vice President, Commercial Services Officer

Elizabeth Goll - Assistant Vice President, Asst. Community Office Manager

James T. Gorman - Sr. Vice President, Commercial Services Officer-Sr. Market Manager

Edgar A. Gower, Jr. - Vice President, Commercial Services Officer

Brenda L. Grasley - Vice President, Consumer Loan Manager

Tina M. Gray - Vice President, Community Office Manager

Herbert Harmon, Jr. - Assistant Cashier, Facilities Manager

Lee A. Hess - Vice President, Commercial Services Officer-Security Officer

Jason P. Holloway - Assistant Cashier, Consumer Loan Officer

Richard L. Holloway - Assistant Vice President, Community Office Manager

June Honorowski - Vice President, Regional Branch Administrator

Rebecca A. Hooper - Trust Officer

Toney C. Horst - Assistant Vice President, Controller

Kathleen M. Jarski - Assistant Vice President, Community Office Manager

Donna J. Keefer - Vice President, Product Support

Brian M. Klinefelter - Assistant Vice President, Credit Department Manager

Matthew R. Knepley - Assistant Cashier, Credit Analyst

Steven M. Kotch - Assistant Cashier, Collector

Kevin Krieger - Vice President, Compliance Officer & BSA Officer

Martin Leandri - Assistant Cashier, Community Office Manager

Jonathan Littlewood - Assistant Vice President, Commercial Services Officer

Leona W. Luongo - Vice President, Mortgage Consultant

Kristi A. McClintock - Assistant Cashier, Commercial Loan Document Specialist

Matthew W. Mensinger - Vice President, Commercial Services Officer

Linda Meshinski - Assistant Cashier, Community Office Manager

Eugene W. Morrison - Vice President, Commercial Services Officer

Bonnie Nevel - Assistant Cashier, Trainer

Laurie Nudo - Assistant Cashier, Customer Service Officer

John J. O'Reilly - Trust Officer

Marilynn Palmer - Vice President, Community Office Manager

Mary E. Pascucci - Assistant Cashier, Training Director

John Procopio - Executive Vice President, Commercial Services Officer-Sr. Market Manager

Michael W. Rider - Assistant Vice President, IT Manager/Information Security Officer

Judith A.M. Rinehart - Vice President, Mortgage Consultant

Holly M. Rodzon - Assistant Cashier, Assistant Community Office Manager

Frances L. Seward - Assistant Vice President, Community Office Manager

Kimberly S. Shiner - Assistant Vice President, Community Office Manager

Sally J. Sitler - Assistant Vice President, Computer Operations Manager

Sherri A. Sitler - Assistant Vice President, Deposit Compliance Specialist

James S. Szewc - Vice President, Sr. Trust Officer

Kimberly A. Volkel - Assistant Cashier, Community Office Manager

Jeffrey T. Wozniak - Assistant Vice President, Technology Systems Manager

Cheryl L. Wynings - Assistant Cashier, Executive Administrative Assistant & Asst. Secretary

Linda K. Yerges - Vice President, Human Resource Manager

Robert A. Young - Vice President, Loan Review Officer

Christopher Zlobik - Assistant Cashier, Assistant IT Manager

CORPORATE INFORMATION

THE CORPORATION

First Keystone Corporation is a bank holding company incorporated under the Pennsylvania Business Corporation Laws. Its assets consist primarily of the assets of its wholly-owned subsidiary, First Keystone Community Bank.

First Keystone Community Bank serves Columbia, Montour, Luzerne, and Monroe Counties. The Bank engages in general banking business and also provides fiduciary services.

CORPORATE HEADQUARTERS

First Keystone Corporation
111 West Front Street
Berwick, Pennsylvania 18603
Telephone: 570-752-3671
Fax: 570-752-4022

NOTICE OF ANNUAL MEETING

The 2013 Annual Meeting of Shareholders will be held at 10:00 a.m., Eastern Daylight Time, on Thursday, May 16, 2013 at:

McBride Memorial Library, Community Room
500 Market Street
Berwick, Pennsylvania 18603

ANNUAL REPORT ON FORM 10-K

The Annual Report on Form 10-K as filed with the Securities and Exchange Commission may be obtained, without charge, by contacting:

Cheryl Wynings
Investor Relations
P.O. Box 289
Berwick, Pennsylvania 18603
Telephone: 570-752-3671, extension 1175

STOCK LISTING

First Keystone Corporation common stock is traded on the Over the Counter (OTC) Bulletin Board under the symbol "FKYS.OB".

TRANSFER AGENT AND REGISTRAR

To change or transfer registration of your stock, report a lost certificate, or other related inquiries, please contact our transfer agent at:

Registrar & Transfer Company
10 Commerce Drive
Cranford, New Jersey 07016
Telephone: 1-800-368-5948
Website: www.rtc.com
Email: info@rtc.com

DIRECT DEPOSIT

Shareholders may have their cash dividends deposited directly into the account of their choice at any banking institution, with no charge. Additional information and enrollment materials for direct deposit can be obtained by calling 1-800-368-5948.

DIVIDEND REINVESTMENT

The Plan, open to residents of Pennsylvania, provides the opportunity to have dividends automatically reinvested into First Keystone Corporation stock. Participants in the Plan may also elect to make cash contributions to purchase additional shares of common stock. For information regarding the Plan, contact the Plan Administrator at:

Registrar and Transfer Company
Investor Relations Department
10 Commerce Drive
Cranford, NJ 07016
Telephone: 1-800-368-5948

INVESTOR INFORMATION

Information regarding First Keystone Corporation is available online at www.firstkeystonecorporation.com. The website also includes additional information of interest to shareholders such as: historical stock prices, dividend declarations, press releases and governance documents.

Requests for information or assistance regarding the corporation should be directed to Shareholder Relations at 1-888-759-2266, extension 1175.

STOCK PURCHASE INQUIRIES

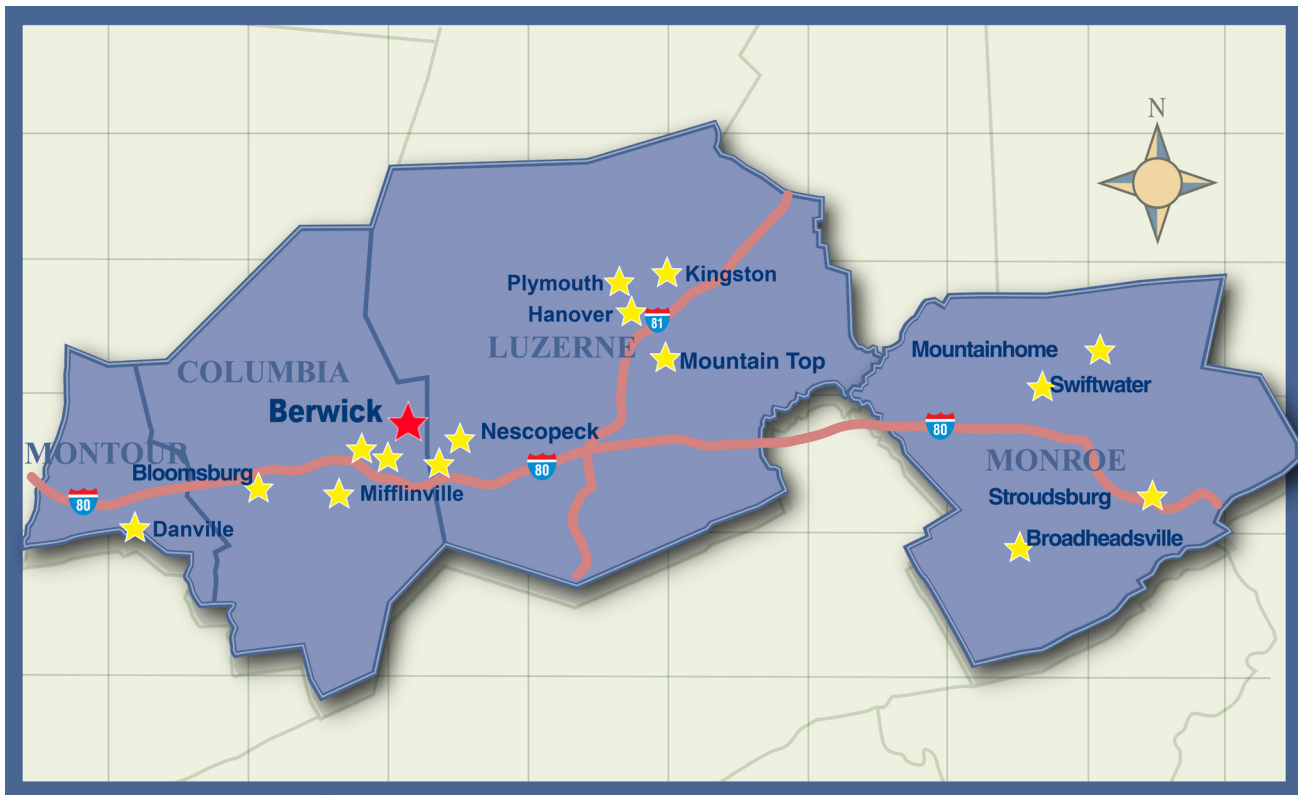
The following brokerage firms make a market in First Keystone Corporation common stock:

RBC Dain Rauscher, (800) 223-4207
Janney Montgomery Scott LLC, (800) 526-6397
Stifel Nicolaus & Co. Inc., (800) 223-6807
Boenning & Scattergood, Inc., (800) 883-1212

INDEPENDENT PUBLIC ACCOUNTANTS

J. H. Williams & Co., LLP
270 Pierce Street
Kingston, Pennsylvania 18704
Telephone: 570-288-3651

OFFICE LOCATIONS



★ HEADQUARTERS: 111 West Front Street, Berwick, PA 18603 Phone: 570-752-3671

FIRST KEYSTONE COMMUNITY BANK

400 Fowler Avenue
Berwick, PA 18603
570-759-2628

2301 Columbia Boulevard
Bloomsburg, PA 17815
570-784-0354

559 Main Street
Stroudsburg, PA 18360
570-424-9700

701 Freas Avenue
Berwick, PA 18603
570-752-1244

1519 Bloom Road
Danville, PA 17821
570-275-8000

154 Route 390
Mountainhome, PA 18342
570-595-9700

50 Briar Creek Plaza
Berwick, PA 18603
570-802-0541

1540 Sans Souci Highway
Hanover Township, PA 18706
570-825-7352

Route 209
Broadheadsville, PA 18322
570-402-2008

437 West Third Street
Nescopeck, PA 18635
570-759-2767

299 Wyoming Avenue
Kingston, PA 18704
570-718-1110

2070 Route 611
Swiftwater, PA 18370
570-839-7880

Third & Race Streets
Mifflinville, PA 18631
570-752-5750

18 N. Mountain Boulevard
Mountain Top, PA 18707
570-715-0720

463 W. Main St.
Plymouth, PA 18651
570-719-1400



Our Progress is Your Progress

Effective change equals continued progress. With this thought in mind, First Keystone Community Bank is committed to forging ahead with positive results.

Pictured on the front cover is First Keystone's new Kingston Community Office, photographed by Morrell Devlin. As the office reached its tenth anniversary at the original site, the value of a more convenient and easily accessible location became readily apparent. Knowing that the new location at the intersection of Wyoming Avenue and Hoyt Street would resound well with our valued local customers, as well as with prospective new customers, the decision was made to build a new full-service facility just three blocks north of the original branch.

Over the past decade, we are honored to have established a solid base of business and personal customer relationships in the Kingston area and throughout our four county market.



Yesterday's Traditions. Tomorrow's Vision.

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