PACCAR INC
Form 11-K
June 24, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 11-K

ý ANNUAL REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2004

OR

o TRANSITION REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 0-6394

PACCAR INC SAVINGS INVESTMENT PLAN

(Full title of plan)

PACCAR Inc

777 106th Avenue, N.E.

Bellevue, Washington 98004

(Name of issuer of securities held pursuant to the

plan and address of its principal executive office)

REQUIRED INFORMATION

A. **Financial Statements and Schedules:**

Report of Independent Registered Public Accounting Firm

Audited Financial Statements:

Statements of Net Assets Available for Benefits

Statement of Changes in Net Assets Available for Benefits

Notes to Financial Statements

Supplemental Schedules:

Schedule H, Line 4i	Schedule of Assets (Held at End of Year)
Schedule H, Line 4j	Schedule of Reportable Transactions

B. **Exhibits**

23	Consent of Independent Registered Public Accounting Firm

SIGNATURES

The Plan. Pursuant to the requirements of the Securities Exchange Act of 1934, the trustees (or other persons who administer the employee benefit plan) have duly caused this annual report to be signed on its behalf by the undersigned hereunto duly authorized.

Date June 24, 2005	PACCAR INC SAVINGS INVESTMENT PLAN	
	By:	/s/ G. V. Huffman G. V. Huffman Acting Human Resources Manager PACCAR Inc

Financial Statements and Supplemental Schedules

PACCAR Inc Savings Investment Plan
As of December 31, 2004 and 2003 and for the year ended December 31, 2004

With Report of Independent Registered Public Accounting Firm

PACCAR Inc
Savings Investment Plan

Financial Statements and Supplemental Schedules

As of December 31, 2004 and 2003 and
for the year ended December 31, 2004

Contents

Report of Independent Registered Public Accounting Firm

The Administrator of the

PACCAR Inc Savings Investment Plan

We have audited the accompanying statements of net assets available for benefits of the PACCAR Inc Savings Investment Plan as of December 31, 2004 and 2003, and the related statement of changes in net assets available for benefits for the year ended December 31, 2004. These financial statements are the responsibility of the Plan s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Plan s internal control over financial reporting. Our audit included consideration of the Plan s internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the Plan at December 31, 2004 and 2003, and the changes in its net assets available for benefits for the year ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

Our audits were performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying supplemental schedules of assets (held at end of year) as of December 31, 2004, and reportable transactions for the year then ended, are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor s Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. These supplemental schedules are the responsibility of the Plan s management. The supplemental schedules have been subjected to the auditing procedures applied in our audits of the financial statements and, in our opinion, are fairly stated in all material respects in relation to the financial statements taken as a whole.

Seattle, Washington
April 22, 2005

/s/ ERNST & YOUNG LLP

PACCAR Inc

Savings Investment Plan

Statements of Net Assets Available for Benefits

	December 31	
	2004	2003
Assets		
Investments, at fair value:		
Money market funds	**$ 147,269**	$ 173,753
Commingled trust funds	**198,598,259**	206,567,123
Mutual funds	**293,857,358**	258,024,232
Common stock	**822,110,445**	557,271,695
Participant loans	**29,706,719**	28,892,907
Total investments	**1,344,420,050**	1,050,929,710
Dividends receivable	**20,416,424**	7,838,201
Due from broker for securities sold	**404,652**	476,045
Total assets	**1,365,241,126**	1,059,243,956
Liabilities		
Accrued expenses	**43,690**	42,109
Net assets available for benefits	**$ 1,365,197,436**	$ 1,059,201,847

See accompanying notes.

PACCAR Inc

Savings Investment Plan

Statement of Changes in Net Assets Available for Benefits

Year Ended December 31, 2004

Additions		
Investment income:		
Net appreciation in fair value of investments	$	**274,976,189**
Interest and dividends		**38,246,205**
		313,222,394
Contributions:		
Company		**15,781,408**
Participants		**33,650,861**
		49,432,269
Total additions		**362,654,663**
Deductions		
Benefits paid to participants		**56,447,269**
Administrative expenses		**211,805**
Total deductions		**56,659,074**
Net increase		**305,995,589**
Net assets available for benefits at beginning of year		**1,059,201,847**
Net assets available for benefits at end of year	$	**1,365,197,436**

PACCAR Inc

Savings Investment Plan

Notes to Financial Statements

December 31, 2004

1. Description of the Plan

The PACCAR Inc Savings Investment Plan (the Plan) is a defined contribution plan covering substantially all nonunion U.S. employees of PACCAR Inc and its U.S. subsidiaries (the Company). Such employees are eligible to participate in the Plan after completion of 30 days of service. Participants are eligible to receive employer contributions after one year of service. The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code of 1986 (the Code). This description of the Plan provides only general information. Participants should refer to the Plan document for a complete description of the Plan s provisions.

Contributions

Participants may elect to contribute not less than 1% and not more than 35% of their respective annual compensation (as defined in the Plan document) subject to the Internal Revenue Service-mandated annual maximum of $13,000 and $12,000 for 2004 and 2003, respectively. Participant contributions to the Plan are excluded from the participants current taxable earnings in accordance with Code Section 401(k). Beginning in 2002, catch-up contributions were made available under the Plan for those participants age 50 and older. The maximum annual catch-up contribution for 2004 and 2003 was $3,000 and $2,000, respectively.

For eligible participants that are actively employed at December 31 of each year, the Company matches participant contributions (other than age 50 catch-up deferrals) to the lesser of 5% of the participants respective annual compensation or their annual salary deferrals. In certain cases, as described in the Plan document, employees who terminated during the year will be eligible to receive matching contributions. Company matches contributions in the form of PACCAR Inc common stock. The Company may suspend or reduce its contributions when its Consolidated Net Earnings are less than 8% of the Company s Capital Base, as defined by the Plan.

Upon reaching age 50, participants who have completed five or more years of service have a one-time opportunity to transfer to any one or more of the other investment options available under the Plan, any whole percentage of the value of his or her PACCAR Inc common stock. See Note 7, Subsequent Events, for 2005 plan amendments. Any future matching contributions allocated to such participants will continue to be made in the form of PACCAR Inc common stock.

Participant Accounts

Individual accounts are maintained for all Plan participants that reflect their contributions and related Company contributions to the Plan and any earnings or losses on the Plan s investments.

Vesting

Plan participants are immediately 100% vested in both participant and Company matching contributions when made, plus any investment earnings thereon.

Investment Options

Upon enrollment in the Plan, a participant may direct their employee contributions in whole percentage increments to any of the Plan s fund options. Participants may subsequently change their investment options for either existing or future participant contributions, in whole percentage increments, subject to trading limitations on certain of the Plan s individual fund options.

Participant Loans

Actively employed participants may borrow from their individual accounts a minimum of $1,000, up to the lesser of $50,000 reduced by the highest outstanding loan balance during the previous 12 months, 50% of the participants total account balance, or the participants total account balance excluding Company matching contributions in the PACCAR Inc common stock fund and related earnings. Loan terms range from 1 to 5 years, or up to 15 years for the purchase of a primary residence, and early payoffs can be made without penalty. The loans are secured by the balance in the participant s account and bear interest equal to the prime rate plus 1%, as determined monthly by the Plan administrator. Interest rates ranged from 5.0% to 10.5% on loans outstanding as of December 31, 2004. Principal and interest are repaid either through after-tax payroll deductions or personal check directly to Fidelity Management Trust Company (the Trustee) at least on a quarterly basis. Loans outstanding will not affect the amount of annual matching contributions the Company pays to participants accounts. The number of loans that a participant can take is limited to two new loans per calendar year.

Benefit Payments

Participants who leave the Company may choose a single cash payment or whole shares of PACCAR Inc common stock included in the participant s account, plus a cash payment for the remaining balance. Effective May 1, 2003, the Plan discontinued the cash installment method of benefit payments. This method of payment was previously offered to participants who left the Company on or after reaching age 55. Participants that leave the Company whose account balance is less than $5,000 will automatically receive a single cash payment. Effective March 28, 2005, this threshold was lowered so that participants whose balance is less than $1,000 will automatically receive a cash payment. Also, active employees who reach age 70½ have the additional options of electing to have their account balance distributed to them or to receive minimum required distributions.

Plan Termination

It is the intention of the Company that the Plan will continue indefinitely. However, should the Company elect to terminate the Plan subject to the provisions of ERISA, the termination date shall be treated as the valuation date, and the balances in the participants accounts will be distributed to them.

Expenses

Third-party management fees are charged to the Plan, and the Company pays all other expenses relating to the Plan s administration.

2. Summary of Accounting Policies

Basis of Accounting

The financial statements have been prepared on the accrual basis of accounting, except for benefit payments which are recorded when paid.

Investment Valuation and Income Recognition

The Plan s investments are stated at fair value. The fair value of the participation units owned by the Plan in mutual funds is based on the mutual funds quoted market prices, which represent the net asset value of the underlying investments as reported by the mutual funds on the last business day of the Plan year. The fair value of participation units in commingled trust funds are based on the quoted market price of the underlying securities and the number of units owned by the Plan at year-end. Investments in securities traded on a national securities exchange are valued at their market prices on the last business day of the Plan year. The money market fund is valued at cost, which approximates fair value. Participant loans are recorded at their outstanding balances, which approximate fair value.

Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

Risks and Uncertainties

The Plan provides for various investment options. Investment securities, in general, are exposed to various risks, such as interest rate, market volatility, and credit. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the value of participants account balances and the amounts reported in the statements of net assets available for benefits and the statement of changes in net assets available for benefits.

3. Investments

Assets held in the Plan are managed and investment transactions are executed by Fidelity Management Trust Company or other outside mutual fund companies.

During 2004, the Plan s investments (including investments purchased, sold, as well as held during the year) appreciated (depreciated) in fair value as determined by quoted market prices as follows:

		Net Appreciation (Depreciation) in Fair Value of Investments
Year Ended December 31, 2004		
Fidelity commingled trust funds:		
U.S. Equity Index Commingled Pool	**$**	**8,633,602**
Fidelity mutual funds:		
Contrafund		**18,145,450**
Asset Manager		**956,602**
Asset Manager: Growth		**1,688,405**
Asset Manager: Income		**798,042**
Freedom Income		**5,507**
Freedom 2000		**26,151**
Freedom 2010		**274,310**
Freedom 2020		**293,927**
Freedom 2030		**95,324**
Freedom 2040		**31,429**
Other mutual funds:		
PIMCO Total Return Fund: Administrative Class		**(45,860)**
Morgan Stanley Institutional Fund, Inc:		
International Equity Portfolio Class B		**290,426**
JP Morgan Mid Cap Value Fund: Institutional Class		**2,954,051**
Other investments:		
PACCAR Inc common stock		**240,828,823**
	$	**274,976,189**

Investments that represent 5% or more of the fair value of the Plan s net assets are as follows:

	December 31	
	2004	**2003**
PACCAR Inc common stock*	**$ 822,110,445**	$ 557,271,695
Contrafund	**139,268,140**	124,823,292
U.S. Equity Index Commingled Pool	**86,036,590**	81,992,726
Managed Income Portfolio II Class 2	**112,561,669**	124,574,397
Asset Manager: Growth	**	45,872,529

*Includes Company matching contributions, which are non-participant directed.

**Investment is less than 5% of the Plan s net assets as of December 31, 2004.

4. Non-participant Directed Investments

The only non-participant directed investments in the Plan are held in PACCAR Inc common stock, in which participant directed investments also are made. The investment activity cannot be split between participant directed and non-participant directed transactions. The information below regarding net assets and the significant changes in net assets relates to the non-participant directed and participant directed transactions in PACCAR Inc common stock.

	December 31	
	2004	2003
Investments in PACCAR Inc common stock at fair value	**$ 822,110,445**	$ 557,271,695
Dividends receivable	**20,416,424**	7,838,201
Less accrued expenses	**(2,044)**	(595)
	$ 842,524,825	$ 565,109,301

		Year Ended December 31, 2004
Changes in net assets:		
Contributions	$	**20,055,057**
Dividends		**27,978,894**
Net appreciation in fair value		**240,828,823**
Net transfers from other participant directed investments		**12,221,051**
Benefits paid to participants		**(23,865,392)**
Other		**197,091**
	$	**277,415,524**

5. Income Tax Status

The Plan has received a determination letter from the Internal Revenue Service dated October 2, 2002, stating that the Plan is qualified under Section 401(a) of the Code and, therefore, the related trust is exempt from taxation. On December 16, 2002, the Plan was amended and restated effective January 1, 2002 to comply with the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). Once qualified, the Plan is required to operate in conformity with the Code to maintain its qualification. The Plan administrator believes the Plan is being operated in compliance with the applicable requirements of the Code and, therefore, believes that the Plan, as amended and restated, is qualified and the related trust is tax exempt.

6. Transactions With Parties in Interest

The Plan invests in the common stock of the Plan s sponsor, PACCAR Inc, which is purchased by the Trustee on the open market at fair value. The Plan made purchases totaling $66,765,460 and sales totaling $67,209,778 of PACCAR Inc common stock during 2004. The Plan received cash dividends on this stock totaling $15,400,671 in 2004. Dividends receivable as of December 31, 2004 and 2003 are $20,416,424 and $7,838,201, respectively.

7. Subsequent Events

Effective April 1, 2005, PACCAR Inc amended and restated the Plan to provide that a portion of the Plan will constitute an employee stock ownership plan within the meaning of Code section 4975(e)(7) and to make certain other amendments as set forth below. Effective July 1, 2005, participants can choose to reinvest dividends in PACCAR Inc common stock or the participants can elect to receive the dividends in cash.

Effective April 1, 2005, participants age 50 or older with five or more years of service have the ability to make an unlimited number of transfers, at any time, of some or all of their Company matching contribution balances held in PACCAR Inc common stock into any of the other investment fund options within the Plan.

PACCAR Inc

Savings Investment Plan

EIN: 91-0351110 Plan Number: 002

Schedule H, Line 4i Schedule of Assets

(Held at End of Year)

December 31, 2004

(a)	(b) Identity of Issue, Fund, or Borrower	(c) Description of Investment	(d) Cost		(e) Current Value
	Money market funds				
*	Fidelity Management Trust Company:				
	Retirement Money Market	147,269 units	(1)	$	147,269
	Commingled trust funds:				
*	Fidelity Management Trust Company:				
	Managed Income Portfolio II Class 2	112,561,669 units	(1)		112,561,669
	U.S. Equity Index Commingled Pool	2,299,214 units	(1)		86,036,590
	Mutual funds				
*	Fidelity Management Trust Company:				
	Contrafund	2,454,497 units	(1)		139,268,140
	Asset Manager	2,146,895 units	(1)		34,801,174
	Asset Manager: Growth	3,114,868 units	(1)		46,162,350
	Asset Manager: Income	1,548,855 units	(1)		19,623,997
	Freedom Income	35,683 units	(1)		402,144
	Freedom 2000	93,268 units	(1)		1,126,683
	Freedom 2010	518,893 units	(1)		7,067,326
	Freedom 2020	380,046 units	(1)		5,305,447
	Freedom 2030	99,369 units	(1)		1,399,116
	Freedom 2040	93,816 units	(1)		775,862
	PIMCO Total Return Fund:				
	Administrative Class	884,608 units	(1)		9,438,769
	Morgan Stanley Institutional Fund, Inc:				
	International Equity Portfolio-Class B	278,216 units	(1)		5,800,804
	JP Morgan Mid Cap Value Fund:				
	Institutional Class	1,017,289 units	(1)		22,685,546
	Other investments				
*	PACCAR Inc common stock	10,215,090 shares	224,257,577		822,110,445
*	Participant loans	Maturing through October 29, 2019, interest rates 5.0% 10.5%	29,706,719		29,706,719
				$	1,344,420,050

*Indicates party in interest to the Plan.

(1) Cost information is omitted, as investments are participant-directed.

PACCAR Inc

Savings Investment Plan

EIN: 91-0351110 Plan Number: 002

Schedule H, Line 4j Schedule of Reportable Transactions

Year Ended December 31, 2004

(a) Identity of Party Involved	**(b) Description of Asset**	**(c) Purchase Price**	**(d) Selling Price**	**(g) Cost of Asset**	**(h) Current Value of Asset on Transaction Date**	**(i) Net Gain**
Category (iii)	**Series of securities transactions aggregating in excess of 5% of Plan assets.**					
PACCAR Inc	Common stock	$ 66,765,460	$	$ 66,765,460	$ 66,765,460	$
	Common stock		$ 42,755,533	18,301,289	42,755,533	$ 24,454,244

There were no category (i), (ii), or (iv) reportable transactions during the year.

Columns (e) and (f) are not applicable.

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Net interest income grew by $1.8 million or 16.7% in 2009. This increase was driven by loan growth through the fourth quarter 2008 acquisition of ECSLA which added $7.3 million to the Corporation's loan portfolio, the extension of three, one-year tax anticipation notes to local municipalities totaling $11.5 million during the first quarter of 2009, and the third quarter 2009 purchase of a branch banking office in Titusville, Pennsylvania from PNC/National City in which $32.6 million of loans were acquired.

- The provision for loan losses increased $867,000 as a result of continued loan growth and pressure on borrowers related to the prevailing poor national economic conditions.
- Impairment charges totaling $898,000 were recognized during the third quarter of 2009 related to three marketable equity securities. Offsetting these impairment charges, the Corporation realized gains on the sale of certain U.S. government agency and mortgage-backed securities totaling $864,000.
- Costs associated with the Titusville branch purchase totaled $592,000 and were recorded during the second and third quarters of 2009. These costs included legal, project management, data conversion and valuation services, printing and mailing costs of required disclosure material, customer check replacement and other conversion costs.
- Stock offering costs totaling $484,000 were recognized during the fourth quarter of 2009 as the Corporation withdrew its common stock offering. These costs were primarily professional fees incurred for legal and accounting services. Also contributing to stock offering costs were fees associated with printing and filing various documents and travel expenses.
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Regular quarterly FDIC insurance premiums increased $402,000 from 2008 to 2009. In addition, the Bank recorded a $178,000 one-time charge during the second quarter of 2009 related to a special assessment that was assessed on all FDIC insured depository institutions.

- The Corporation recorded extraordinary income in 2008 totaling $906,000 associated with the acquisition of ECSLA.
- The Corporation's total assets grew by $91.9 million during 2009, primarily related to the Titusville branch purchase.

Changes in Financial Condition

Total assets increased $91.9 million or 24.5% to $467.5 million at December 31, 2009 from $375.7 million at December 31, 2008. This increase was due primarily to increases in securities available for sale, net loans receivable and cash and equivalents of $33.8 million, $27.8 million and $22.4 million, respectively.

The increase in the Corporation's total assets was primarily funded by increases in total liabilities of $91.0 million or 26.8% and total stockholders' equity of $911,000 or 2.5%. The increase in total liabilities was primarily due to an increase in total deposits of $98.7 million or 34.4%, partially offset by a decrease in borrowed funds of $8.2 million or 17.0%.

Cash and cash equivalents. These accounts increased a combined $22.4 million or 135.1% to $39.0 million at December 31, 2009 from $16.6 million at December 31, 2008. This increase was primarily due to cash received from the Titusville branch office purchase that had not yet been deployed into higher-yielding assets. Typically, cash accounts are increased by net operating results, deposits by customers into savings and checking accounts, loan and security repayments and proceeds from borrowed funds. Decreases result from customer deposit withdrawals, new loan originations or other loan fundings, security purchases, repayments of borrowed funds and cash dividends to stockholders.

Securities. Securities increased $33.8 million or 47.3% to $105.2 million at December 31, 2009 from $71.4 million at December 31, 2008. This increase was primarily related to the partial deployment of cash received from the Titusville branch office purchase into higher-yielding investment securities, offset by security calls, sales and repayments.

Loans receivable. Net loans receivable increased $27.8 million or 10.5% to $292.6 million at December 31, 2009 from $264.8 million at December 31, 2008, primarily related to $32.6 million of loans acquired through the Titusville branch purchase, offset by normal amortization and payoffs. Home equity loans and lines of credit increased $19.8 million or 34.5%, commercial real estate increased $4.3 million or 5.0% and consumer loans increased $3.5 million or 36.7%.

Non-performing assets. Non-performing assets include non-accrual loans, loans 90 days past due and still accruing, repossessions and real estate owned. Non-performing assets were $2.6 million or 0.56% of total assets at December 31, 2009 compared to $1.1 million or 0.28% of total assets at December 31, 2008. Non-performing assets consisted of non-performing loans, repossessions and real estate owned of $2.4 million, $40,000 and $173,000, respectively, at December 31, 2009 and $1.0 million, $0 and $50,000, respectively, at December 31, 2008. This increase in non-performing assets was due to continued pressure on borrowers related to the prevailing poor economic climate. At December 31, 2009, non-performing assets consisted primarily of commercial and residential mortgage loans.

Federal bank stocks. Federal bank stocks were comprised of FHLB stock and FRB stock of $3.5 million and $662,000, respectively, at December 31, 2009. These stocks are purchased and redeemed at par as directed by the federal banks and levels maintained are based primarily on borrowing and other correspondent relationships between the Corporation and the banks. In December 2008, the FHLB notified member banks that it was suspending dividend payments and the repurchase of capital stock. Management evaluated the FHLB stock for impairment and determined that no impairment charge was necessary as of December 31, 2009.

Bank-owned life insurance (BOLI). The Corporation maintains single premium life insurance policies on twenty current and former officers and employees of the Bank. In addition to providing life insurance coverage, whereby the Bank as well as the officers and employees receive life insurance benefits, the appreciation of the cash surrender value of the BOLI will serve to offset and finance existing and future employee benefit costs. Increases in this account during 2009 were associated with an increase in the cash surrender value of the policies, partially offset by certain administrative expenses.

Premises and equipment. Premises and equipment increased $561,000 or 6.5% to $9.2 million at December 31, 2009 from $8.6 million at December 31, 2008. The overall increase in premises and equipment during the year was due to capital expenditures of $1.5 million, partially offset by normal depreciation and amortization of $860,000. Major capital expenditures during the year included the construction of a new building for the Corporation's East Brady, Pennsylvania branch office and extensive renovations at the Ridgway, Pennsylvania branch office.

Goodwill. Goodwill increased $2.2 million or 157.2% to $3.7 million at December 31, 2009 from $1.4 million at December 31, 2008. In connection with the Titusville branch purchase, the Bank recorded goodwill of $2.2 million. Goodwill represents the excess of the total purchase price paid for the Titusville branch over the fair value of the assets acquired, net of the fair value of the liabilities assumed. The entire amount of goodwill will be tax deductible and amortized over 15 years for income tax purposes. Goodwill will be evaluated for possible impairment at least annually, and more frequently, if events and circumstances indicate that the asset might be impaired.

Core deposit intangible. Core deposit intangible was $2.6 million at December 31, 2009. In connection with the assumption of deposits through the Titusville branch purchase, the Bank recorded a core deposit intangible of $2.8 million. This asset represents the value ascribed to the long-term value of the core deposits acquired. Fair value was determined using a third-party valuation expert specializing in estimating fair values of core deposit intangibles. The fair value was derived using an industry standard financial instrument present value methodology. All-in costs and runoff balances by year were discounted by comparable term FHLB advance rates, used as an alternative cost of funds measure. This intangible asset will be amortized on a double declining balance method of amortization over a weighted average estimated life of nine years. The core deposit intangible asset is not estimated to have a significant residual value. During 2009, the Corporation recorded $203,000 of intangible amortization related to the core deposit intangible.

Deposits. Total deposits increased $98.7 million or 34.4% to $385.3 million at December 31, 2009 from $286.6 million at December 31, 2008. Noninterest bearing deposits increased $10.7 million or 19.0% during the year and interest bearing deposits increased $88.0 million or 38.2%. Overall deposit growth was primarily attributable to the Titusville branch purchase, as deposits assumed with the branch purchase totaled $90.8 million. Organic deposit growth in existing offices totaled $7.9 million or 2.8%.

Borrowed funds. Borrowed funds decreased $8.2 million or 17.0% to $40.0 million at December 31, 2009 from $48.2 million at December 31, 2008 related to a decrease in short-term borrowings.

Stockholders' equity. Stockholders' equity increased $911,000 or 2.5% to $37.0 million at December 31, 2009 from $36.1 million at December 31, 2008 resulting primarily from an increase in retained earnings totaling $127,000 related to net income less preferred and common stock dividends and a decrease in accumulated other comprehensive loss totaling $645,000, resulting primarily from a change in the funded status of the Corporation's defined benefit plan.

Changes in Results of Operations

The Corporation reported net income of $1.5 million and $2.4 million in 2009 and 2008, respectively. The following "Average Balance Sheet and Yield/Rate Analysis" and "Analysis of Changes in Net Interest Income" tables should be utilized in conjunction with the discussion of the net interest income and interest expense components of net income.

Average Balance Sheet and Yield/Rate Analysis. The following table sets forth, for the periods indicated, information concerning the total dollar amounts of interest income from interest-earning assets and the resulting average yields, the total dollar amounts of interest expense on interest-bearing liabilities and the resulting average costs, net interest income, interest rate spread and the net interest margin earned on average interest-earning assets. For purposes of this table, average loan balances include non-accrual loans and exclude the allowance for loan losses and interest income includes accretion of net deferred loan fees. Interest and yields on tax-exempt loans and securities (tax-exempt for federal income tax purposes) are shown on a fully tax equivalent basis. The information is based on average daily balances during the periods presented.

	Year ended December 31,					
	2009			2008		
(Dollar amounts in thousands)	Average Balance	Interest	Yield / Rate	Average Balance	Interest	Yield / Rate
Interest-earning assets:						
Loans, taxable	$ 269,192	$ 16,768	6.23%	$ 240,714	$ 15,906	6.61%
Loans, tax-exempt	14,841	614	4.14%	5,954	370	6.21%
Total loans receivable	284,033	17,382	6.12%	246,668	16,276	6.60%
Securities, taxable	51,227	1,871	3.65%	44,447	1,992	4.48%
Securities, tax-exempt	20,595	1,256	6.10%	14,031	921	6.56%
Total securities	71,822	3,127	4.35%	58,478	2,913	4.98%
Interest-earning deposits with banks	33,107	362	1.09%	7,515	201	2.67%
Federal bank stocks	4,044	28	0.69%	2,868	102	3.56%
Total interest-earning cash equivalents	37,151	390	1.05%	10,383	303	2.92%
Total interest-earning assets	393,006	20,899	5.32%	315,529	19,492	6.18%
Cash and due from banks	2,187			5,512		
Other noninterest-earning assets	18,627			14,928		
Total Assets	$ 413,820			$ 335,969		
Interest-bearing liabilities:						
Interest-bearing demand deposits	$ 125,797	1,049	0.83%	$ 92,208	1,332	1.44%
Time deposits	138,855	4,843	3.49%	121,275	5,083	4.19%
Total interest-bearing deposits	264,652	5,892	2.23%	213,483	6,415	3.00%
Borrowed funds, short-term	15,611	124	0.79%	10,096	182	1.80%
Borrowed funds, long-term	35,000	1,566	4.47%	35,000	1,571	4.49%
Total borrowed funds	50,611	1,690	3.34%	45,096	1,753	3.89%
Total interest-bearing liabilities	315,263	7,582	2.40%	258,579	8,168	3.16%
	58,126	-	-	48,696	-	-

Noninterest-bearing demand deposits						
Funding and cost of funds	373,389	7,582	2.03%	307,275	8,168	2.66%
Other noninterest-bearing liabilities	4,076			2,762		
Total Liabilities	377,465			310,037		
Stockholders' Equity	36,355			25,932		
Total Liabilities and Stockholders' Equity	$ 413,820			$ 335,969		
Net interest income		$ 13,317			$ 11,324	
Interest rate spread (difference between weighted average rate on interest-earning assets and interest-bearing liabilities)			2.92%			3.02%
Net interest margin (net interest income as a percentage of average interest-earning assets)			3.39%			3.59%

Analysis of Changes in Net Interest Income. The following table analyzes the changes in interest income and interest expense in terms of: (1) changes in volume of interest-earning assets and interest-bearing liabilities and (2) changes in yields and rates. The table reflects the extent to which changes in the Corporation's interest income and interest expense are attributable to changes in rate (change in rate multiplied by prior year volume), changes in volume (changes in volume multiplied by prior year rate) and changes attributable to the combined impact of volume/rate (change in rate multiplied by change in volume). The changes attributable to the combined impact of volume/rate are allocated on a consistent basis between the volume and rate variances. Changes in interest income on loans and securities reflect the changes in interest income on a fully tax equivalent basis.

	2009 versus 2008 Increase (decrease) due to		
(Dollar amounts in thousands)	Volume	Rate	Total
Interest income:			
Loans	$ 2,345	$ (1,239)	$ 1,106
Securities	611	(397)	214
Interest-earning deposits with banks	340	(179)	161
Federal bank stocks	30	(104)	(74)
Total interest-earning assets	3,326	(1,919)	1,407
Interest expense:			
Deposits	1,346	(1,869)	(523)
Borrowed funds	200	(263)	(63)
Total interest-bearing liabilities	1,546	(2,132)	(586)
Net interest income	$ 1,780	$ 213	$ 1,993

2009 Results Compared to 2008 Results

The Corporation reported net income before accumulated preferred stock dividends and discount accretion of $1.5 million and $2.4 million for 2009 and 2008, respectively. The $891,000 or 36.6% decrease in net income was attributed to increases in noninterest expense and the provision for loan losses of $1.6 million and $867,000, respectively, partially offset by increases in net interest income and noninterest income of $1.8 million and $343,000, respectively, and a decrease in the provision for income taxes of $298,000. In addition, during 2008, the Corporation recorded extraordinary income totaling $906,000 associated with the ECSLA acquisition.

Net interest income. The primary source of the Corporation's revenue is net interest income. Net interest income is the difference between interest income on earning assets such as loans and securities, and interest expense on liabilities, such as deposits and borrowed funds, used to fund the earning assets. Net interest income is impacted by the volume and composition of interest-earning assets and interest-bearing liabilities, and changes in the level of interest rates. Tax equivalent net interest income increased $2.0 million to $13.3 million for 2009, compared to $11.3 million for 2008. This increase in net interest income can be attributed to an increase in tax equivalent interest income of $1.4 million and a decrease in interest expense of $586,000.

Interest income. Tax equivalent interest income increased $1.4 million or 7.2% to $20.9 million for 2009, compared to $19.5 million for 2008. This increase can be attributed to increases in interest earned on loans, securities and interest-earning deposits of $1.1 million, $214,000, and $161,000, partially offset by a decrease in dividends on federal bank stocks of $74,000.

Tax equivalent interest earned on loans receivable increased $1.1 million or 6.8% to $17.4 million for 2009, compared to $16.3 million for 2008. During that time, average loans increased $37.4 million or 15.2%, generating $2.3 million of additional loan interest income. The increase in average loans outstanding can primarily be attributable to loans acquired through the Titusville branch purchase. Offsetting this favorable asset growth, the yield on loans decreased 48 basis points to 6.12% for 2009, versus 6.60% for 2008 due to declines in market interest rates throughout 2009 causing a $1.2 million decrease in interest income.

Tax equivalent interest earned on securities increased $214,000 or 7.3% to $3.1 million for 2009, compared to $2.9 million for 2008. During this time, average securities increased $13.3 million or 22.8% accounting for $611,000 in additional security interest income. This increase was primarily related to the deployment of cash received in association with the Titusville branch purchase into higher yielding investment securities. The average yield on securities decreased 63 basis points to 4.35% for 2009, versus 4.98% for 2008 in part due to calls of certain higher rate securities and purchases of shorter term, lower yielding investments.

Interest earned on interest-earning deposit accounts increased $161,000 or 80.1% to $362,000 for 2009, compared to $201,000 for 2008. Average interest-earning deposits increased $25.6 million or 340.6% primarily related to cash received from the Titusville branch purchase and the timing associated with the deployment of that cash. This increase generated $340,000 of additional interest income. Partially offsetting the favorable volume variance, the average yield decreased 158 basis points due primarily to a change in asset mix from primarily certificates of deposit to cash held with the Federal Reserve resulting in a $179,000 decrease in interest income. Interest earned on federal bank stocks decreased $74,000 or 72.6% to $28,000 for 2009, compared to $102,000 for 2008 due to the suspension of dividend payments by the FHLB.

Interest expense. Interest expense decreased $586,000 or 7.2% to $7.6 million for 2009, compared to $8.2 million for 2008. This decrease can be attributed to decreases in interest incurred on interest-bearing deposits and borrowed funds of $523,000 and $63,000, respectively.

Deposit interest expense decreased $523,000 or 8.2% to $5.9 million for 2009, compared to $6.4 million for 2008. Declines in market interest rates caused the rate on interest-bearing deposits to decrease by 77 basis points to 2.23% for 2009 versus 3.00% for 2008 accounting for a $1.9 million decrease in interest expense. Average interest-bearing deposits increased $51.2 million or 24.0%, primarily due to deposits assumed related to the Titusville branch purchase. This increase accounted for $1.3 million in additional interest expense.

Interest expense on borrowed funds decreased $63,000 or 3.6% to $1.7 million for 2009, compared to $1.8 million for 2008. The average rate on borrowed funds decreased 55 basis points to 3.34% for 2009 versus 3.89% for 2008 due to lower short-term borrowing rates in 2009. This decrease in rate accounted for $263,000 of reduced interest expense. Average borrowed funds increased $5.5 million or 12.2% accounting for an increase in interest expense of $200,000.

Provision for loan losses. The Corporation records provisions for loan losses to maintain a level of total allowance for loan losses that management believes, to the best of its knowledge, covers all known and inherent losses that are both probable and reasonably estimable at each reporting date. Management considers historical loss experience, the present and prospective financial condition of borrowers, current conditions (particularly as they relate to markets where the Corporation originates loans), the status of non-performing assets, the estimated underlying value of the collateral and other factors related to the collectability of the loan portfolio.

The provision for loan losses increased $867,000 to $1.4 million for 2009, compared to $500,000 for 2008. The Corporation's allowance for loan losses amounted to $3.2 million or 1.08% of the Corporation's total loan portfolio at December 31, 2009, compared to $2.7 million or 0.99% at December 31, 2008. The allowance for loan losses as a percentage of non-performing loans at December 31, 2009 and 2008 was 132.4% and 262.2%, respectively. The increase in the provision for loan losses was due to management's estimates of the impact on the loan portfolio of credit defaults related to the continued recessionary economic climate, charge-offs, increases in classified and nonperforming assets and loan growth in general.

Noninterest income. Noninterest income includes revenue that is not related to interest rates, but rather to services rendered and activities conducted in the financial services industry, including fees on depository accounts, general transaction and service fees, commissions on financial services, title premiums, security and loan gains and losses, and earnings on BOLI. Noninterest income increased $343,000 or 13.8% to $2.8 million for 2009, compared to $2.5 million for 2008. This increase was primarily due to a decrease in net losses on securities available for sale. During 2009, the Corporation realized security losses of $898,000 as management determined that three marketable equity securities were impaired. The impairment of these financial industry securities were considered to be other than temporary due to developments in the financial conditions and near-term prospects of the issuers, a downturn of economic conditions of the industry and deteriorating book values of the securities. Offsetting these impairment charges, the Corporation sold several U.S. agency and mortgage-backed securities and realized gains of $864,000. During 2008, the Corporation realized security losses of $391,000 as management determined that two marketable equity securities were impaired.

Noninterest expense. Noninterest expense increased $1.6 million or 14.4% to $12.6 million for 2009, compared to $11.0 million for 2008. This increase in noninterest expense was comprised of increases in premises and equipment, intangible amortization, professional fees, federal deposit insurance and other expenses, partially offset by a decrease in compensation and employee benefits expense.

The largest component of noninterest expense, compensation and employee benefits, decreased $293,000 or 4.6% to $6.1 million for 2009, compared to $6.3 million for 2008. This decrease was primarily due to the elimination of the Corporation's incentive programs as part of its capital management and preservation plan adopted during the first quarter of 2009. In addition, severance charges were recognized in the fourth quarter of 2008, principally associated with the previously disclosed retirement of the Corporation's former Chairman of the Board, President and Chief Executive Officer.

Premises and equipment expense increased $185,000 or 10.8% to $1.9 million for 2009, compared to $1.7 million for 2008, primarily related to costs associated with the Titusville branch purchase.

The Corporation recognized $203,000 of intangible amortization associated with a core deposit intangible asset of $2.8 million that was recorded related to the Titusville branch purchase transaction.

Professional fees increased $791,000 to $1.3 million for 2009, compared to $501,000 for 2008. This increase is attributable to the aforementioned branch purchase and stock offering. Professional fees related to the branch purchase totaled $376,000 and included legal fees, project management fees and conversion assistance costs. Professional fees associated with the stock offering, consisting mainly of legal and accounting fees, were $399,000.

FDIC expense increased $580,000 to $662,000 for 2009, compared to $82,000 for 2008. This was the result of increases in base assessment rates for FDIC insurance premiums and a special assessment that was assessed on all FDIC insured depository institutions in 2009. The special assessment totaled $178,000 and was recognized during the second quarter of 2009.

Other noninterest expense increased $120,000 or 5.0% to $2.5 million for 2009, compared to $2.4 million for 2008 due primarily to $216,000 of costs related to the branch purchase. These included costs associated with customer check and debit card replacement and the printing and mailing of required legal disclosures to affected customers. In addition, $85,000 of costs were recognized related to the stock offering consisting of printing and filing fees, NASDAQ listing fees and travel and other expenses.

The provision for income taxes decreased $298,000 or 83.7% to $58,000 for 2009, compared to $356,000 for 2008 due to lower pre-tax income with an increased portion of pre-tax income being generated from tax-exempt investment securities and loans.

Market Risk Management

Market risk for the Corporation consists primarily of interest rate risk exposure and liquidity risk. The Corporation is not subject to currency exchange risk or commodity price risk, and has no trading portfolio, and therefore, is not subject to any trading risk. In addition, the Corporation does not participate in hedging transactions such as interest rate swaps and caps. Changes in interest rates will impact both income and expense recorded and also the market value of long-term interest-earning assets.

The primary objective of the Corporation's asset liability management function is to maximize the Corporation's net interest income while simultaneously maintaining an acceptable level of interest rate risk given the Corporation's operating environment, capital and liquidity requirements, balance sheet mix, performance objectives and overall business focus. One of the primary measures of the exposure of the Corporation's earnings to interest rate risk is the timing difference between the repricing or maturity of interest-earning assets and the repricing or maturity of its interest-bearing liabilities.

The Corporation's Board of Directors has established a Finance Committee, consisting of four outside directors, the President and Chief Executive Officer (CEO) and the Principal Accounting Officer (PAO), to monitor market risk, including primarily interest rate risk. This committee, which meets at least quarterly, generally establishes and monitors the investment, interest rate risk and asset liability management policies established by the Corporation.

In order to minimize the potential for adverse affects of material and prolonged changes in interest rates on the Corporation's results of operations, the Corporation's management has implemented and continues to monitor asset liability management policies to better match the maturities and repricing terms of the Corporation's interest-earning assets and interest-bearing liabilities. Such policies have consisted primarily of (i) originating adjustable-rate mortgage loans; (ii) originating short-term secured commercial loans with the rate on the loan tied to the prime rate or reset features in which the rate changes at determined intervals; (iii) emphasizing investment in shorter-term (15 years or less) investment securities; (iv) selling longer-term (30-year) fixed-rate residential mortgage loans in the secondary market; (v) maintaining a high level of liquid assets (including securities classified as available for sale) that can be readily reinvested in higher yielding investments should interest rates rise; (vi) emphasizing the retention of lower-costing savings accounts and other core deposits; and (vii) lengthening liabilities and locking in lower borrowing rates with longer terms whenever possible.

Interest Rate Sensitivity Gap Analysis

The implementation of asset and liability initiatives and strategies and compliance with related policies, combined with other external factors such as demand for the Corporation's products and economic and interest rate environments in general, has resulted in the Corporation maintaining a one-year cumulative interest rate sensitivity gap ranging between a positive and negative 20% of total assets. The one-year interest rate sensitivity gap is identified as the difference between the Corporation's interest-earning assets that are scheduled to mature or reprice within one year and its interest-bearing liabilities that are scheduled to mature or reprice within one year.

The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets maturing or repricing within a specific time period and the amount of interest-bearing liabilities maturing or repricing within that time period. A gap is considered positive when the amount of interest rate-sensitive assets exceeds the amount of interest rate-sensitive liabilities, and is considered negative when the amount of interest rate-sensitive liabilities exceeds the amount of interest rate-sensitive assets. Generally, during a period of rising interest rates, a negative gap would adversely affect net interest income while a positive gap would result in an increase in net interest income. Conversely, during a period of falling interest rates, a negative gap would result in an increase in net interest income and a positive gap would adversely affect net interest income. The closer to zero, or more neutral, that gap is maintained, generally, the lesser the impact of market interest rate changes on net interest income.

Based on certain assumptions provided by a federal regulatory agency, which management believes most accurately represents the sensitivity of the Corporation's assets and liabilities to interest rate changes, at December 31, 2009, the Corporation's interest-earning assets maturing or repricing within one year totaled $141.0 million while the Corporation's interest-bearing liabilities maturing or repricing within one-year totaled $136.3 million, providing an excess of interest-earning assets over interest-bearing liabilities of $4.8 million or 1.0% of total assets. At December 31, 2009, the percentage of the Corporation's assets to liabilities maturing or repricing within one year was 103.5%.

The following table presents the amounts of interest-earning assets and interest-bearing liabilities outstanding as of December 31, 2009 which are expected to mature, prepay or reprice in each of the future time periods presented:

(Dollar amounts in thousands)	Due in six months or less	Due within six months to one year	Due within one to three years	Due within three to five years	Due in over five years	Total
Total interest-earning assets	$ 108,606	$ 32,399	$ 129,331	$ 81,372	$ 82,653	$ 434,361
Total interest-bearing liabilities	86,715	49,538	92,557	74,712	116,860	420,382
Maturity or repricing gap during the period	$ 21,891	$ (17,139)	$ 36,774	$ 6,660	$ (34,207)	$ 13,979
Cumulative gap	$ 21,891	$ 4,752	$ 41,526	$ 48,186	$ 13,979	
Ratio of gap during the period to total assets	4.68%	(3.67)%	7.87%	1.42%	(7.32)%	
Ratio of cumulative gap to total assets	4.68%	1.02%	8.88%	10.31%	2.99%	
Total assets						$ 467,526

Although certain assets and liabilities may have similar maturities or periods of repricing, they may react in different degrees to changes in market interest rates. The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types of assets and liabilities may lag behind changes in market interest rates. In the event of a change in interest rates, prepayment and early withdrawal levels would likely deviate significantly from those assumed in calculating the table. The ability of many borrowers to service their debt may decrease in the event of an interest rate increase.

The one-year interest rate sensitivity gap has been the most common industry standard used to measure an institution's interest rate risk position regarding maturities, repricing and prepayments. In recent years, in addition to utilizing interest rate sensitivity gap analysis, the Corporation has increased its emphasis on the utilization of interest rate sensitivity simulation analysis to evaluate and manage interest rate risk.

Interest Rate Sensitivity Simulation Analysis

The Corporation also utilizes income simulation modeling in measuring its interest rate risk and managing its interest rate sensitivity. The Finance Committee of the Corporation believes that simulation modeling enables the Corporation to more accurately evaluate and manage the possible effects on net interest income due to the exposure to changing market interest rates, the slope of the yield curve and different loan and security prepayment and deposit decay assumptions under various interest rate scenarios.

As with gap analysis and earnings simulation modeling, assumptions about the timing and variability of cash flows are critical in net portfolio equity valuation analysis. Particularly important are the assumptions driving mortgage prepayments and the assumptions about expected attrition of the core deposit portfolios. These assumptions are based on the Corporation's historical experience and industry standards and are applied consistently across the different rate risk measures.

The Corporation has established the following guidelines for assessing interest rate risk:

Net interest income simulation. Given a 200 basis point parallel and gradual increase or decrease in market interest rates, net interest income may not change by more than 25% for a one-year period.

Portfolio equity simulation. Portfolio equity is the net present value of the Corporation's existing assets and liabilities. Given a 200 basis point immediate and permanent increase or decrease in market interest rates, portfolio equity may not correspondingly decrease or increase by more than 30% of stockholders' equity.

These guidelines take into consideration the current interest rate environment, the Corporation's financial asset and financial liability product mix and characteristics and liquidity sources among other factors. Given the current rate environment, a drop in short-term market interest rates of 200 basis points immediately or over a one-year horizon would seem unlikely. This should be considered in evaluating modeling results outlined in the table below.

The following table presents the simulated impact of a 100 basis point or 200 basis point upward or downward shift of market interest rates on net interest income, for the years ended December 31, 2009 and 2008, respectively. This analysis was done assuming that the interest-earning asset and interest-bearing liability levels at December 31, 2009 remained constant. The impact of the market rate movements on net interest income was developed by simulating the effects of rates changing gradually during a one-year period from the December 31, 2009 levels for net interest income.

	Increase		Decrease	
	+100 BP	+200 BP	-100 BP	-200 BP
2009 Net interest income - increase (decrease)	2.64%	4.42%	(5.87)%	(11.02)%
2008 Net interest income - increase (decrease)	2.71%	3.37%	(4.42)%	(7.52)%

Impact of Inflation and Changing Prices

The consolidated financial statements of the Corporation and related notes presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America which require the measurement of financial condition and operating results in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation.

Unlike most industrial companies, substantially all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services since such prices are affected by inflation to a larger degree than interest rates. In the current interest rate environment, liquidity and the maturity structure of the Corporation's assets and liabilities are critical to the maintenance of acceptable performance levels.

Capital Resources

Total stockholders' equity increased $911,000 or 2.5% to $37.0 million at December 31, 2009 from $36.1 million at December 31, 2008. Net income of $1.5 million in 2009 represented a decrease in earnings of $891,000 or 36.7% compared to 2008. Returns on average equity and assets were 4.23% and 0.37%, respectively, for 2009.

K-35

The Corporation has maintained a strong capital position with a capital to assets ratio of 7.9% at December 31, 2009. In an effort to sustain this strong capital position, regular cash dividends on common stock decreased to $1.1 million in 2009 from $1.7 million in 2008. Stockholders have taken part in the Corporation's dividend reinvestment plan introduced during 2003 with 47% of registered shareholder accounts active in the plan at December 31, 2009.

Capital adequacy is intended to enhance the Corporation's ability to support growth while protecting the interest of shareholders and depositors and to ensure that capital ratios are in compliance with regulatory minimum requirements. Regulatory agencies have developed certain capital ratio requirements that are used to assist them in monitoring the safety and soundness of financial institutions. At December 31, 2009, the Corporation and the Bank were in excess of all regulatory capital requirements.

Liquidity

The Corporation's primary sources of funds generally have been deposits obtained through the offices of the Bank, borrowings from the FHLB, and amortization and prepayments of outstanding loans and maturing securities. During 2009, the Corporation used its sources of funds primarily to fund loan commitments. As of December 31, 2009, the Corporation had outstanding loan commitments, including undisbursed loans and amounts available under credit lines, totaling $46.1 million, and standby letters of credit totaling $1.5 million. The Bank is required by the OCC to establish policies to monitor and manage liquidity levels to ensure the Bank's ability to meet demands for customer withdrawals and the repayment of short-term borrowings, and the Bank is currently in compliance with all liquidity policy limits.

At December 31, 2009, time deposits amounted to $164.2 million or 42.6% of the Corporation's total consolidated deposits, including approximately $53.0 million, which are scheduled to mature within the next year. Management of the Corporation believes that the Corporation has adequate resources to fund all of its commitments, that all of its commitments will be funded as required by related maturity dates and that, based upon past experience and current pricing policies, it can adjust the rates of time deposits to retain a substantial portion of maturing liabilities.

Aside from liquidity available from customer deposits or through sales and maturities of securities, the Corporation has alternative sources of funds such as a line of credit and term borrowing capacity from the FHLB and, to a more limited extent, through the sale of loans. At December 31, 2009, the Corporation's borrowing capacity with the FHLB, net of funds borrowed, was $130.3 million.

The Corporation paid quarterly cash dividends over the past two years and determined to reduce the quarterly cash dividend from $0.32 per share to $0.14 per share effective for the second quarter of 2009. The determination of future dividends on the Corporation's common stock will depend on conditions existing at that time with consideration given to the Corporation's earnings, capital and liquidity needs, among other factors.

Management is not aware of any conditions, including any regulatory recommendations or requirements, that would adversely impact its liquidity or its ability to meet funding needs in the ordinary course of business.

Critical Accounting Policies

The Corporation's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and follow general practices within the industry in which it operates. Application of these principles requires management to make estimates or judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates or judgments. Certain policies inherently have a greater reliance on the use of estimates, and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates or judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by third-party sources, when available. When third-party information is not available, valuation adjustments are estimated in good faith by management primarily though the use of internal cash flow modeling techniques.

The most significant accounting policies followed by the Corporation are presented in Note 1 to the consolidated financial statements. These policies, along with the disclosures presented in the other financial statement notes provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Management views critical accounting policies to be those which are highly dependent on subjective or complex judgments, estimates and assumptions and where changes in those estimates and assumptions could have a significant impact on the financial statements. Management has identified the following as critical accounting policies.

Allowance for loan losses. The Corporation considers that the determination of the allowance for loan losses involves a higher degree of judgment and complexity than its other significant accounting policies. The balance in the allowance for loan losses is determined based on management's review and evaluation of the loan portfolio in relation to past loss experience, the size and composition of the portfolio, current economic events and conditions and other pertinent factors, including management's assumptions as to future delinquencies, recoveries and losses. All of these factors may be susceptible to significant change. Among the many factors affecting the allowance for loan losses, some are quantitative while others require qualitative judgment. Although management believes its process for determining the allowance adequately considers all of the potential factors that could potentially result in credit losses, the process includes subjective elements and may be susceptible to significant change. To the extent actual outcomes differ from management's estimates, additional provisions for loan losses may be required that would adversely impact the Corporation's financial condition or earnings in future periods.

Other-than-temporary impairment. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic, market or other concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, (3) the intent of the Corporation to sell a security, and (4) whether it is more likely than not the Corporation will have to sell the security before recovery of its cost basis.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Information required by this item is included in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in item 7.

Item 8. Financial Statements and Supplementary Data

Information required by this item is included herein beginning on page F-1.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

On February 17, 2010, the Corporation's Board of Directors dismissed its independent auditors, ParenteBeard LLC (ParenteBeard). ParenteBeard will complete its engagement as independent auditor for the Corporation's fiscal year ended December 31, 2009 upon the filing of the Corporation's Form 10-K for the year ended December 31, 2009. ParenteBeard's report on the Corporation's consolidated financial statements during the two most recent fiscal years preceding the date hereof contained no adverse opinion or a disclaimer of opinions, and was not qualified or modified as to uncertainty, audit scope or accounting principles. The decision to change accountants was approved by the Corporation's Audit Committee. During the last two fiscal years and the subsequent interim period to the date hereof, there were no disagreements between the Corporation and ParenteBeard on any matters of accounting principles or practices, financial statement disclosure, or auditing scope or principles, which disagreement(s), if not resolved to the satisfaction of ParenteBeard, would have caused it to make a reference to the subject matter of the disagreement(s) in connection with its reports. None of the "reportable events" described in Item 304(a)(1)(v) of Regulation S-K occurred with respect to the Corporation within the last two fiscal years and the subsequent interim period to the date hereof.

Effective February 17, 2010, the Corporation engaged Crowe Horwath LLP (Crowe Horwath) as its independent auditors for the fiscal year ending December 31, 2010. The Corporation engaged Crowe Horwath to perform limited non-audit services related to the years ending December 31, 2009 and 2008. The services performed during this period included preparation of consolidated federal and state tax returns, assisting management with quarterly estimated tax payments, effective tax rates, deferred tax inventory, tax related journal entries and discussions on tax matters related to a branch acquisition. On occasion, Crowe Horwath also informally discussed with management of the Corporation general accounting topics and/or issues.

The nature of Crowe Horwath's involvement with the Corporation as indicated above did not result in any conclusion on the type of audit opinion(s) rendered or to be rendered, views expressed, management's final decisions as to the accounting, auditing or financial reporting requirements nor a disagreement or reportable event.

Item 9A(T). Controls and Procedures

The Corporation maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Corporation's Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Corporation's management, including its CEO and PAO, as appropriate, to allow timely decisions regarding required disclosure based on the definition of "disclosure controls and procedures" in Rule 13a-15(e).

As of December 31, 2009, the Corporation carried out an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's CEO and PAO, of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures. Based on the foregoing, the Corporation's CEO and PAO concluded that the Corporation's disclosure controls and procedures were effective.

There have been no significant changes in the Corporation's internal controls or in other factors that could significantly affect the internal controls subsequent to the date the Corporation completed its valuation.

During the fourth quarter of fiscal year 2009, there has been no change made in the Corporation's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Corporation. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Management completed an assessment of the Corporation’s internal control over financial reporting as of December 31, 2009. This assessment was based on criteria for evaluating internal control over financial reporting established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management concluded that the Corporation’s internal control over financial reporting was effective as of December 31, 2009.

This annual report does not include an attestation report of the Corporation’s registered public accounting firm regarding internal control over financial reporting. The Corporation’s internal control over financial reporting was not subject to attestation by the Corporation’s registered public accounting firm pursuant to temporary rules of the SEC that permit the Corporation to provide only management’s report in this annual report.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this item is incorporated herein by reference to the sections captioned “Principal Beneficial Owners of the Corporation’s Common Stock”, “Section 16(a) Beneficial Ownership Reporting Compliance” and “Information With Respect to Nominees For Director, Continuing Director and Executive Officers” in the Corporation’s definitive proxy statement for the Corporation’s Annual Meeting of Stockholders to be held on April 28, 2010 (the Proxy Statement) which will be filed no later than 120 days following the Corporation’s fiscal year end.

The Corporation maintains a Code of Personal and Business Conduct and Ethics (the Code) that applies to all employees, including the CEO and the PAO. A copy of the Code has previously been filed with the SEC and is posted on our website at www.farmersnb.com. Any waiver of the Code with respect to the CEO and the PAO will be publicly disclosed in accordance with applicable regulations.

Item 11. Executive Compensation

The information required by this item is incorporated herein by reference to the section captioned “Executive Compensation” in the Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this item is incorporated herein by reference to the section captioned “Principal Beneficial Owners of the Corporation’s Common Stock” in the Proxy Statement.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item is incorporated herein by reference to the sections captioned “Information With Respect to Nominees For Director, Continuing Directors and Executive Officers” and “Executive Compensation” in the Proxy Statement.

Item 14. Principal Accountant Fees and Services

The information required by this item is incorporated herein by reference to the section captioned “Relationship With Independent Registered Public Accounting Firm” in the Proxy Statement.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a)(1)-(2) Financial Statements and Schedules:

(i) The financial statements required in response to this item are incorporated by reference from Item 8 of this report.

(3) Management Contracts or Compensatory Plans:

(i) Exhibits 10.1-10.6 listed below in (b) identify management contracts or compensatory plans or arrangements required to be filed as exhibits to this report, and such listing is incorporated herein by reference.

(b) Exhibits are either attached as part of this Report or incorporated herein by reference.

2.1 Agreement and Plan of Merger by and between Emclaire Financial Corp. and Elk County Savings and Loan Association. (1)

3.1 Articles of Incorporation of Emclaire Financial Corp. (2)

3.2 Bylaws of Emclaire Financial Corp. (2)

3.3 Statement with respect to shares for Preferred Stock. (3)

4.0 Specimen Stock Certificate of Emclaire Financial Corp. (4)

4.1 Form of certificate for Preferred Stock. (3)

4.2 Warrant for purchase of shares of Common Stock. (3)

10.1 Employment Agreement between Emclaire Financial Corp., the Farmers National Bank of Emlenton and certain executive officers, dated as of July 1, 2007. (5)

10.2 Change in Control Agreement between Emclaire Financial Corp., the Farmers National Bank of Emlenton and certain executive officers, dated as of July 1, 2007. (5)

10.3 Change in Control Agreement between Emclaire Financial Corp., the Farmers National Bank of Emlenton and certain executive officer, dated as of May 12, 2008.

10.4 Group Term Carve-Out Plan between the Farmers National Bank of Emlenton and 20 Officers and Employees. (6)

10.5 Supplemental Executive Retirement Plan Agreement between the Farmers National Bank of Emlenton and Six Officers. (6)

10.6 Adoption of Farmers National Bank of Emlenton Deferred Compensation Plan. (7)

10.7 Letter Agreement, dated December 23, 2008 between the Corporation and the U.S. Department of the Treasury. (3)

11.0 Statement regarding computation of earnings per share (see Note 1 of the Notes to Consolidated Financial Statements in the Annual Report).

13.0	Annual Report to Stockholders for the fiscal year ended December 31, 2009.
14.0	Code of Personal and Business Conduct and Ethics. (8)
20.0	Emclaire Financial Corp. Dividend Reinvestment and Stock Purchase Plan. (9)
21.0	Subsidiaries of the Registrant (see information contained herein under "Item 1. Description of Business - Subsidiary Activity").
31.1	Principal Executive Officer 302 Certification.
31.2	Principal Accounting Officer 302 Certification.
32.1	Principal Executive Officer 906 Certification.
32.2	Principal Accounting Officer 906 Certification.
99.1	Principal Executive Officer 111 Certification.
99.2	Principal Financial Officer 111 Certification.

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(1) Incorporated by reference to the Registrant's Current Report on Form 8-K dated October 20, 2008.
(2) Incorporated by reference to the Registrant's Registration Statement on Form SB-2, as amended, (File No. 333-11773) declared effective by the SEC on October 25, 1996.
(3) Incorporated by reference to the Registrant's Current Report on Form 8-K dated December 23, 2008.
(4) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1997.
(5) Incorporated by reference to the Registrant's Current Report on Form 8-K dated June 21, 2007.
(6) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2002.
(7) Incorporated by reference to the Registrant's Current Report on Form 8-K dated December 15, 2008.
(8) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2004.
(9) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2001.

SIGNATURES

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

EMCLAIRE FINANCIAL CORP.

Dated: March 22, 2010	By:	/s/ William C. Marsh William C. Marsh Chairman, Chief Executive Officer, President and Director (Duly Authorized Representative)

Pursuant to the requirement of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

By:	/s/ William C. Marsh William C. Marsh Chairman of the Board Chief Executive Officer President Director (Principal Executive Officer)	By:	/s/ Amanda L. Engles Amanda L. Engles Treasurer (Principal Accounting Officer)
Date:	March 22, 2010	Date:	March 22, 2010
By:	/s/ Ronald L. Ashbaugh Ronald L. Ashbaugh Director	By:	/s/ David L. Cox David L. Cox Director
Date:	March 22, 2010	Date:	March 22, 2010
By:	/s/ James M. Crooks James M. Crooks Director	By:	/s/ George W. Freeman George W. Freeman Director
Date:	March 22, 2010	Date:	March 22, 2010
By:	/s/ Mark A. Freemer Mark A. Freemer Director	By:	/s/ Robert L. Hunter Robert L. Hunter Director
Date:	March 22, 2010	Date:	March 22, 2010
By:	/s/ John B. Mason John B. Mason Director	By:	/s/ Brian C. McCarrier Brian C. McCarrier Director
Date:	March 22, 2010	Date:	March 22, 2010

K-42

Financial Statements
Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Emclaire Financial Corp.
Emlenton, Pennsylvania

We have audited the accompanying consolidated balance sheets of Emclaire Financial Corp. and subsidiaries (the "Corporation") as of December 31, 2009 and 2008, and the related consolidated statements of income, changes in stockholders' equity and comprehensive income, and cash flows for each of the years in the two-year period ended December 31, 2009. Emclaire Financial Corp.'s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Corporation is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Emclaire Financial Corp. and subsidiaries as of December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America.

/s/ ParenteBeard LLC
Pittsburgh, Pennsylvania
March 22, 2010

Consolidated Balance Sheets

(Dollar amounts in thousands, except share data)

	December 31, 2009	December 31, 2008
Assets		
Cash and due from banks	$ 2,822	$ 4,292
Interest earning deposits with banks	36,130	12,279
Total cash and cash equivalents	38,952	16,571
Securities available for sale, at fair value	105,243	71,443
Loans receivable, net of allowance for loan losses of $3,202 and $2,651	292,615	264,838
Federal bank stocks, at cost	4,125	3,797
Bank-owned life insurance	5,388	5,186
Accrued interest receivable	1,574	1,519
Premises and equipment, net	9,170	8,609
Goodwill	3,657	1,422
Core deposit intangible	2,585	-
Prepaid expenses and other assets	4,217	2,279
Total Assets	$ 467,526	$ 375,664
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Non-interest bearing	$ 67,033	$ 56,351
Interest bearing	318,292	230,296
Total deposits	385,325	286,647
Borrowed funds:		
Short-term	5,000	13,188
Long-term	35,000	35,000
Total borrowed funds	40,000	48,188
Accrued interest payable	711	761
Accrued expenses and other liabilities	4,456	3,945
Total Liabilities	430,492	339,541
Commitments and Contingencies	-	-
Stockholders' Equity		
Preferred stock, $1.00 par value, 3,000,000 shares authorized; 7,500 shares issued and outstanding	7,430	7,412
Warrants	88	88
Common stock, $1.25 par value, 12,000,000 shares authorized; 1,559,421 shares issued; 1,431,404 shares outstanding	1,949	1,949
Additional paid-in capital	14,685	14,564
Treasury stock, at cost; 128,017 shares	(2,653)	(2,653)
Retained earnings	15,967	15,840
Accumulated other comprehensive loss	(432)	(1,077)
Total Stockholders' Equity	37,034	36,123
Total Liabilities and Stockholders' Equity	$ 467,526	$ 375,664

See accompanying notes to consolidated financial statements.

F-3

Consolidated Statements of Income

(Dollar amounts in thousands, except share data)

	Year ended December 31, 2009	2008
Interest and dividend income		
Loans receivable, including fees	$ 17,203	$ 16,162
Securities:		
Taxable	1,871	1,992
Exempt from federal income tax	870	636
Federal bank stocks	28	102
Deposits with banks	362	201
Total interest and dividend income	20,334	19,093
Interest expense		
Deposits	5,892	6,415
Short-term borrowed funds	124	182
Long-term borrowed funds	1,566	1,571
Total interest expense	7,582	8,168
Net interest income	12,752	10,925
Provision for loan losses	1,367	500
Net interest income after provision for loan losses	11,385	10,425
Noninterest income		
Fees and service charges	1,495	1,638
Commissions on financial services	389	449
Title premiums	62	-
Other-than-temporary impairment losses on equity securities	(898)	(391)
Net gain on sales of loans	4	6
Net gain on sales of available for sale securities	864	-
Earnings on bank-owned life insurance	232	227
Other	682	558
Total noninterest income	2,830	2,487
Noninterest expense		
Compensation and employee benefits	6,054	6,347
Premises and equipment	1,899	1,714
Intangible asset amortization	203	-
Professional fees	1,292	501
Federal deposit insurance	662	82
Other	2,508	2,388
Total noninterest expense	12,618	11,032
Income before provision for income taxes and extraordinary item	1,597	1,880
Provision for income taxes	58	356
Income before extraordinary item	1,539	1,524
Extraordinary item, gain on business combination	-	906
Net income	1,539	2,430
Accumulated preferred stock dividends and discount accretion	393	-
Net income available to common stockholders	$ 1,146	$ 2,430
Earnings per common share		
Net income before extraordinary item	$ 0.80	$ 1.17

Extraordinary item, gain on business combination		-		0.70
Net income (basic)	$	0.80	$	1.87
Net income (diluted)	$	0.80	$	1.87

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Stockholders' Equity

(Dollar amounts in thousands, except share data)

	Preferred Stock	Warrants	Common Stock	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
Balance at January 1, 2008	$ -	$ -	$ 1,745	$ 10,902	$ (2,653)	$ 15,114	$ (405)	$ 24,703
Comprehensive income:								
Net income						2,430		2,430
Change in net unrealized losses on securities available for sale, net of taxes of $129							251	251
Change in funded status of defined benefit plan, net of taxes of ($475)							(923)	(923)
Comprehensive income								1,758
Issuance of common stock			204	3,549				3,753
Issuance of preferred stock	7,412							7,412
Issuance of warrants		88						88
Stock compensation expense				113				113
Cash dividends declared on common stock ($1.30 per share)						(1,704)		(1,704)
Balance at December 31, 2008	7,412	88	1,949	14,564	(2,653)	15,840	(1,077)	36,123
Comprehensive income:								
Net income						1,539		1,539
Change in net unrealized losses on securities available for sale, for which a portion of an other than temporary impairment has been recognized in earnings, net of taxes of $145							280	280
Change in net unrealized losses on securities available for sale, net of taxes of ($70)							(135)	(135)
Change in funded status of defined benefit plan, net of taxes of $258							500	500
Comprehensive income								2,184
Stock compensation expense				121				121

Preferred dividends and amortization of discount	18					(353)		(335)
Cash dividends declared on common stock ($0.74 per share)						(1,059)		(1,059)
Balance at December 31, 2009	$ 7,430	$ 88	$ 1,949	$ 14,685	$ (2,653)	$ 15,967	$ (432)	$ 37,034

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(Dollar amounts in thousands, except share data)

	Year ended December 31, 2009	2008
Cash flows from operating activities		
Net income	$ 1,539	$ 2,430
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	860	737
Provision for loan losses	1,367	500
Amortization of premiums and (accretion of discounts), net	176	(161)
Amortization of intangible assets and mortgage servicing rights	220	17
Securities impairment loss recognized in earnings	898	391
Realized gains on sales of available for sale securities, net	(864)	-
Net gains on sales of loans	(4)	(6)
Net (gains) losses on foreclosed real estate	4	(96)
Net gains on sales of bank premises and equipment	(16)	-
Originations of loans sold	(159)	(1,209)
Proceeds from the sale of loans	163	1,215
Restricted stock and stock option compensation	121	113
Increase in bank-owned life insurance, net	(202)	(199)
(Increase) decrease in accrued interest receivable	88	(154)
Increase in deferred taxes	(286)	(433)
Increase in prepaid expenses and other assets	(1,627)	(913)
Decrease in accrued interest payable	(50)	(10)
Increase in accrued expenses and other liabilities	1,011	1,438
Net cash provided by operating activities	3,239	3,660
Cash flows from investing activities		
Loan originations and principal collections, net	2,784	(35,818)
Available for sale securities:		
Sales	20,513	-
Maturities, repayments and calls	40,697	70,999
Purchases	(94,720)	(90,361)
Purchase of federal bank stocks	(328)	(1,135)
Proceeds from the sale of bank premises and equipment	203	-
Proceeds from the sale of foreclosed real estate	99	463
Net cash received in branch acquisition	54,923	-
Purchases of premises and equipment	(1,530)	(1,442)
Net cash provided by (used in) investing activities	22,641	(57,294)
Cash flows from financing activities		
Net increase in deposits	6,083	42,385
Net change in short-term borrowings	(8,188)	7,788
Proceeds from sale of preferred stock	-	7,412
Issuance of warrants	-	88
Proceeds from sale of common stock	-	3,753
Dividends paid	(1,394)	(1,704)
Net cash provided by (used in) financing activities	(3,499)	59,722
Net increase in cash and cash equivalents	22,381	6,088
Cash and cash equivalents at beginning of period	16,571	10,483

Cash and cash equivalents at end of period	$	38,952	$	16,571
Supplemental information:				
Interest paid	$	7,632	$	8,178
Income taxes paid		183		805
Supplemental noncash disclosures:				
Transfers from loans to foreclosed real estate		227		288
Summary of branch acquisition:				
Fair value of deposits assumed		92,596		-
Less: Fair value of tangible assets acquired		32,673		-
Cash received in acquisition		54,923		-
Goodwill and other intangibles recorded	$	5,000	$	-

See accompanying notes to consolidated financial statements.

1. Summary of Significant Accounting Policies

Basis of Presentation and Consolidation. The consolidated financial statements include the accounts of Emclaire Financial Corp. (the Corporation) and its wholly owned subsidiaries, the Farmers National Bank of Emlenton (the Bank) and Emclaire Settlement Services, LLC (the Title Company). All significant intercompany balances and transactions have been eliminated in consolidation.

Nature of Operations. The Corporation provides a variety of financial services to individuals and businesses through its offices in Western Pennsylvania. Its primary deposit products are checking, savings and term certificate accounts and its primary lending products are residential and commercial mortgages, commercial business loans and consumer loans.

Use of Estimates and Classifications. In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP), management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, fair value of financial instruments, goodwill, the valuation of deferred tax assets and other than temporary impairment charges. Certain amounts previously reported may have been reclassified to conform to the current year financial statement presentation. Such reclassifications did not affect net income or stockholders' equity.

Significant Group Concentrations of Credit Risk. Most of the Corporation's activities are with customers located within the Western Pennsylvania region of the country. Note 4 discusses the type of securities that the Corporation invests in. Note 5 discusses the types of lending the Corporation engages in. The Corporation does not have any significant concentrations to any one industry or customer.

Cash Equivalents. For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash on hand, cash items, interest-earning deposits with other financial institutions and federal funds sold and due from correspondent banks. Interest-earning deposits mature within one year and are carried at cost. Federal funds are generally sold or purchased for one day periods. Net cash flows are reported for loan and deposit transactions.

Restrictions on Cash. Cash on hand or on deposit with the Federal Reserve Bank of Cleveland (FRB) of approximately $60,000 was required to meet regulatory reserve and clearing requirements at December 31, 2009 and 2008. Both required and excess reserves earn interest.

Securities. Debt securities are classified as available for sale when they might be sold before maturity. Equity securities with readily determinable fair values are classified as available for sale. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized using the interest method over the term of the securities. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

1. Summary of Significant Accounting Policies (continued)

Securities (continued). Management evaluates securities for other-than-temporary impairment (OTTI) at least on a quarterly basis, and more frequently when economic or market conditions warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, (3) the intent of the Corporation to sell a security, and (4) whether it is more likely than not the Corporation will have to sell the security before recovery of its cost basis. If the Corporation intends to sell an impaired security, or if it is more likely than not the Corporation will have to sell the security before recovery of its cost basis, the Corporation records an other-than-temporary loss in an amount equal to the entire difference between fair value and amortized cost. Otherwise, only the credit portion of the estimated loss on debt securities is recognized in earnings, with the other portion of the loss recognized in other comprehensive income.

Loans Held for Sale. Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income. Loans held for sale are generally sold with servicing rights retained. The carrying value of such loans sold is reduced by the cost allocated to the servicing rights. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

Loans Receivable. The Corporation grants mortgage, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans throughout Western Pennsylvania. The ability of the Corporation's debtors to honor their contracts is dependent upon real estate and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or net pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans or premiums or discounts on purchased loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, and premiums and discounts are deferred and recognized as an adjustment of the related loan yield using the interest method.

The accrual of interest on loans is typically discontinued at the time the loan is 90 days past due unless the credit is well secured and in the process of collection. Loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not collected for loans that are placed on nonaccrual status or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Loan Losses. The allowance for loan losses is established for probable credit losses through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are typically credited to the allowance.

1. Summary of Significant Accounting Policies (continued)

Allowance for Loan Losses (continued). The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of loans in light of historic experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties 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.

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial loans by either the present value of expected future cash flows discounted at the loans effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Large groups of small balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer and residential mortgage loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Federal Bank Stocks. The Bank is a member of the Federal Home Loan Bank of Pittsburgh (FHLB) and the FRB. As a member of these federal banking systems, the Bank maintains an investment in the capital stock of the respective regional banks, at cost. These stocks are purchased and redeemed at par as directed by the federal banks and levels maintained are based primarily on borrowing and other correspondent relationships.

Bank-Owned Life Insurance (BOLI). The Bank purchased life insurance policies on certain key officers and employees. BOLI is recorded at its cash surrender value, or the amount that can be realized.

1. Summary of Significant Accounting Policies (continued)

Premises and Equipment. Land is carried at cost. Premises, furniture and equipment, and leasehold improvements are carried at cost less accumulated depreciation or amortization. Depreciation is calculated on a straight-line basis over the estimated useful lives of the related assets, which are twenty-five to fifty years for buildings and three to ten years for furniture and equipment. Amortization of leasehold improvements is computed using the straight-line method over the shorter of their estimated useful life or the expected term of the leases. Expected terms include lease option periods to the extent that the exercise of such option is reasonably assured. Premises and equipment are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, assets are recorded at fair value.

Goodwill and Intangible Assets. Goodwill results from business acquisitions and represents the excess of the purchase price over the fair value of acquired assets and liabilities. Core deposit intangible assets arise from whole bank or branch acquisitions and are measured at fair value and then are amortized over their estimated lives, generally less than ten years. Customer relationship intangible assets arise from the purchase of a customer list from another company or individual and then are amortized on a straight-line basis over two years. Goodwill is not amortized and is assessed at least annually for impairment and any such impairment will be recognized in the period identified.

Servicing Assets. Servicing assets represent the allocated value of retained servicing rights on loans sold. Servicing assets are expensed in proportion to, and over the period of, estimated net servicing revenues. Impairment is evaluated based on the fair value of the assets, using groupings of the underlying loans as to interest rates. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Any impairment of a grouping is reported as a valuation allowance, to the extent that fair value is less than the capitalized amount for a grouping.

Real Estate Acquired Through Foreclosure (REO). Real estate properties acquired through foreclosure are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations of the properties, gains and losses on sales and additions to the valuation allowance are included in operating results. Real estate acquired through foreclosure is classified in prepaid expenses and other assets and totaled $173,000 and $50,000 at December 31, 2009 and 2008, respectively.

Treasury Stock. Common stock purchased for treasury is recorded at cost. At the date of subsequent reissue, the treasury stock account is reduced by the cost of such stock on the first-in, first-out basis.

Income Taxes. Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax basis of the various balance sheet assets and liabilities and gives current recognition to changes in tax rate and laws.

1. Summary of Significant Accounting Policies (continued)

Earnings Per Common Share (EPS). EPS on income before extraordinary income is computed by dividing income before extraordinary item by the weighted average number of common shares outstanding during the period and EPS on the extraordinary item is computed by dividing the extraordinary item by the weighted average number of common shares outstanding during the period. Basic EPS excludes dilution and is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted EPS reflects the potential dilution that could occur if securities or contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Corporation. Options and restricted stock awards of 107,500 shares of common stock and warrants to purchase 50,111 shares of common stock were not included in computing diluted earnings per share because their effects were not dilutive.

Comprehensive Income. Comprehensive income includes net income from operating results and the net change in accumulated other comprehensive income. Accumulated other comprehensive income (loss) is comprised of unrealized holding gains and losses on securities available for sale and the over funded or under funded status of pension and other postretirement benefit plans on the balance sheet. The effects of other comprehensive income are presented as part of the statement of changes in stockholders' equity.

Operating Segments. Operations are managed and financial performance is evaluated on a corporate-wide basis. Accordingly, all financial services operations are considered by management to be aggregated in one reportable operating segment.

Retirement Plans. The Corporation maintains a noncontributory defined benefit plan covering substantially all employees and officers. Effective January 1, 2009 the plan was closed to new participants. The plan calls for benefits to be paid to eligible employees at retirement based primarily on years of service and compensation rates near retirement. The Corporation also maintains a 401(k) plan, which covers substantially all employees, and a supplemental executive retirement plan for key executive officers.

Stock Compensation Plans. The Corporation follows guidance issued by the Financial Accounting Standards Board (FASB) requiring that the compensation cost relating to share-based payment transactions be recognized in financial statements. The cost is measured based on the fair value of the equity or liability instruments issued. The guidance covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans. An entity is required to measure the cost of employee services received in exchange for the stock options based on the grant-date fair value of the award, and to recognize the cost over the period the employee is required to provide services for the award. An entity may use any option-pricing model that meets the fair value objective of the guidance.

Transfers of Financial Assets. Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Corporation, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

1. Summary of Significant Accounting Policies (continued)

Off-Balance Sheet Financial Instruments. In the ordinary course of business, the Corporation has entered into off-balance sheet financial instruments, consisting of commitments to extend credit, commitments under line of credit lending arrangements and letters of credit. Such financial instruments are recorded in the financial statements when they are funded or related fees are received.

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

Recently Adopted Accounting Standards. In June 2009, the FASB replaced The Hierarchy of Generally Accepted Accounting Principles, with the FASB Accounting Standards Codification (the Codification) as the single source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities. The Codification reorganizes all previous GAAP pronouncements into roughly 90 accounting topics and displays all topics using a consistent structure. All existing standards that were used to create the Codification have been superseded, replacing the previous references to specific Statements of Financial Accounting Standards (SFAS) with numbers used in the Codification's structural organization. The guidance was effective for interim and annual periods ending after September 15, 2009. After September 15, 2009, only one level of authoritative GAAP exists, other than guidance issued by the Securities and Exchange Commission (SEC). All other accounting literature excluded from the Codification is considered non-authoritative. The adoption of the Codification does not have a material impact on the Corporation's consolidated financial statements.

In September 2006, the FASB issued guidance that defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This guidance also establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The guidance was effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued guidance that delayed the effective date of this fair value guidance for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The adoption of this guidance did not have a material impact on the Corporation's consolidated financial statements.

In December 2007, the FASB issued guidance that requires an acquirer to recognize assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date. The guidance requires prospective application for business combinations consummated in fiscal years beginning on or after December 15, 2009. The branch purchase described in Note 2 was accounted for under this guidance.

In December 2008, the FASB issued guidance requiring additional disclosures about plan assets in an employer's defined benefit pension and other postretirement plans. The required disclosures have been included in Note 14.

1. Summary of Significant Accounting Policies (continued)

Recently Adopted Accounting Standards (continued). In April 2009, the FASB issued guidance amending the previous OTTI guidance for debt securities and included additional presentation and disclosure requirements for both debt and equity securities. The guidance was effective for interim reporting periods ending after June 15, 2009. The adoption of this guidance requires an adjustment to retained earnings and other comprehensive income in the period of adoption to reclassify non-credit related impairment to other comprehensive income for debt securities that the Corporation does not have the intent to sell and will not more likely than not be required to sell. The adoption of this guidance did not have a material impact on the Corporation's consolidated financial statements.

In April 2009, the FASB issued guidance that emphasizes that the objective of a fair value measurement does not change even when market activity for the asset or liability has decreased significantly. Fair value is the price that would be received for an asset sold or paid to transfer a liability in an orderly transaction that is not a forced liquidation or distressed sale between market participants at the measurement date under current market conditions. When observable transactions or quoted prices are not considered orderly, then little, if any, weight should be assigned to the indication of the asset or liability's fair value. Adjustments to those transactions or prices should be applied to determine the appropriate fair value. The adoption of this guidance was effective for interim and annual reporting periods ending after June 15, 2009 and did not have a material impact on the Corporation's consolidated financial statements.

In May 2009, the FASB issued guidance that establishes general standards of accounting for and disclosure of subsequent events. Subsequent events are events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Events occurring subsequent to the date of the balance sheet have been evaluated for potential recognition or disclosure in the consolidated financial statements through the date of the filing of the consolidated financial statements with the SEC. In February 2010, the FASB issued amendments to this guidance clarifying which entities are required to evaluate subsequent events through the date the financial statements are issued and the scope of subsequent events disclosures. This amendment removes the requirement for an SEC filer to disclose the date through which subsequent events have been evaluated in both issued and revised financial statements. Except as noted in the guidance, all amendments or additions to this guidance were effective upon issuance. The adoption of this guidance did not have a material impact on the Corporation's consolidated financial statements.

In August 2009, the FASB amended existing guidance related to the measurement of liabilities that are recognized or disclosed at fair value on a recurring basis. This amendment clarifies how a corporation should measure the fair value of liabilities and that restrictions preventing the transfer of a liability should not be considered as a factor in the measurement of liabilities. The adoption of this guidance did not have a material impact on the Corporation's consolidated financial statements.

2. Business Combinations

On April 6, 2009, the Bank entered into a Purchase and Assumption Agreement with National City Bank (National City) and PNC Financial Services Group, Inc. (PNC) where the Bank agreed to acquire certain assets and assume certain liabilities of one National City branch office located in Titusville, Pennsylvania. The Board of Governors of the Federal Reserve System and U.S. Department of Justice required National City to divest of this and other branch locations in connection with of its acquisition by PNC.

The primary purpose of the Titusville branch acquisition was to expand the Bank's presence into a new market with demographics consistent with its current market area. The deposits assumed through the Titusville branch acquisition have a favorable composition mix and the loans acquired currently present limited risk since none of these loans are presently greater than thirty days past due. The Titusville branch acquisition is expected to result in increased earnings and provide additional liquidity that has been used to payoff certain short-term borrowings and to fund future loan and securities growth.

On August 28, 2009, the Bank completed the Titusville branch acquisition and assumed $90.8 million of deposits and acquired $32.6 million of loans and $58.0 million in cash, as well as certain fixed assets associated with the branch office. The Bank retained all existing employees of the office.

The $90.8 million of deposits assumed in the branch acquisition consisted of, approximately $47.9 million of certificates of deposit, or 53% of the deposits assumed, $23.9 million of interest bearing checking, savings and money market accounts, or 26% of the deposits assumed, and $19.0 million of non-interest bearing accounts, or 21% of the deposits assumed. The interest rates on interest bearing checking, savings and money market accounts were adjusted to the Bank's current deposit rates. The interest rates and maturities on the certificates of deposit were assumed at stated contractual terms. Also at the closing of the acquisition, the Bank assumed the obligations under the Titusville branch property lease.

In connection with the assumption of deposits, the Bank recorded a core deposit intangible of $2.8 million. This asset represents the value ascribed to the long-term value of the core deposits acquired. Fair value was determined using a third-party valuation expert specializing in estimating fair values of core deposit intangibles. The fair value was derived using an industry standard financial instrument present value methodology. All-in costs and runoff balances by year were discounted by comparable term FHLB advance rates, used as an alternative cost of funds measure. This intangible asset will be amortized on a double declining balance method of amortization over a weighted average estimated life of nine years. The core deposit intangible asset is not estimated to have a significant residual value.

The $32.6 million of loans acquired consisted of approximately $20.3 million of home equity loans, or 63% of the loans acquired, $9.9 million of commercial loans, or 30% of the loans acquired and $2.4 million of consumer loans, or 7% of the loans acquired. Of the loans acquired, approximately 50% are fixed rate loans and 50% are variable rate loans. The Bank did not acquire any subprime loans and generally did not receive any loans that had a delinquency status of greater than 30 days as of the date of closing.

The Bank's payment of the 3.4% premium on the assumed deposits and the purchase price for the acquired loans and other assets of the Titusville branch office was made through a reduction of the cash received from National City to fund the deposits assumed by the Bank. Net of this premium paid, the Bank received a cash settlement amount of approximately $54.9 million from National City.

F-14

Notes to Consolidated Financial Statements (continued)

2. Business Combinations (continued)

In connection with the branch acquisition, the Bank recorded goodwill of $2.2 million. Goodwill represents the excess of the total purchase price paid for the Titusville branch over the fair value of the assets acquired, net of the fair value of the liabilities assumed. The entire amount of goodwill will be tax deductible and amortized over 15 years for income tax purposes. Goodwill will be evaluated for possible impairment at least annually, and more frequently, if events and circumstances indicate that the asset might be impaired.

The Corporation recorded the following assets and liabilities in connection with the branch purchase as of August 28, 2009:

(Dollar amounts in thousands)	Assets Acquired and Liabilities Assumed	Acquisition Adjustments
Assets:		
Cash and cash equivalents	$ 58,017	$ (3,094)(1)
Loans receivable, net of allowance for loan losses	32,553	(101)(2)
Premises and equipment, net	78	-
Goodwill	-	2,213(3)
Other intangible assets	-	2,787(4)
Prepaid expenses and other assets	143	-
	$ 90,791	$ 1,805
Liabilities and Stockholders' Equity:		
Deposits		
Non-interest bearing	$ 18,974	$ -
Interest bearing	71,817	1,805(5)
	$ 90,791	$ 1,805

(1) Represents a deposit premium paid of approxiamtely 3.4% of the average daily balance of the assumed deposits for the thirty calendar day period ending on and including the second business day prior to the closing date.
(2) The purchase accounting adjustment on loans relates to the fair value adjustment that includes an interest rate component and a credit adjustment for estimated lifetime losses.
(3) The goodwill adjustment relates to the recording of acquired assets and assumed liabilities at fair value.
(4) Represents the estimated fair value of the core deposit intangible asset (approximately 6.5% of core deposits) associated with deposits assumed. The core deposit intangible is being amortized using the double declining balance method of amortization over nine years.
(5) The purchase accounting adjustment on deposits relates to the fair value adjustment of the certificates of deposit.

On October 17, 2008, the Corporation completed an acquisition of Elk County Savings and Loan Association (ECSLA), a Pennsylvania-chartered savings association located in Ridgway, Pennsylvania. ECSLA converted from the mutual to the stock form of organization and immediately issued all of its capital stock to the Corporation and merged with and into the Bank. In connection with the merger, the Corporation issued 163,569 shares of its common stock at a price of $21.15 per share, resulting in proceeds of $3,459,484, net of discount on common stock of $293,279.

2. Business Combinations (continued)

The Corporation recorded the following assets and liabilities of ECSLA as of October 17, 2008. These amounts represent the carrying value of ECSLA's assets and liabilities adjusted to reflect the fair value at the date of the acquisition. The discounts and premiums resulting from the fair value adjustments are being accreted and amortized on a level yield basis over the anticipated lives of the underlying financial assets or liabilities. This amortization of premiums and discounts did not have a material impact on the Corporation's results of operations and is not projected to have a material impact on future periods.

(Dollar amounts in thousands)		Acquired on October 17, 2008
Assets		
Cash and cash equivalents	$	504
Securities available for sale		283
Loans receivable, net of allowance for loan losses of $206		7,321
Federal bank stocks, at cost		44
Other assets		47
Total assets acquired	$	8,199
Liabilities		
Deposits	$	6,221
Other liabilities		119
Total liabilities assumed	$	6,340

The excess fair value of assets acquired over liabilities assumed, less transaction costs incurred, resulted in negative goodwill of $906,000. This negative goodwill is reflected as an extraordinary item in the Corporation's consolidated financial statements.

The primary purpose of the ECSLA acquisition was to expand the Corporation's deposit market share in Ridgway and to provide additional capital to the Bank. The Corporation's deposit market share approximately doubled and capital was added through the negative goodwill generated and the issuance of common stock.

3. Participation in the U.S. Department of the Treasury (U.S. Treasury) Capital Purchase Program (CPP)

The Corporation entered into a Securities Purchase Agreement (the Agreement) on December 23, 2008 with the U.S. Treasury In association with its participation in the CPP of the Emergency Economic Stabilization Act of 2008 (EESA). Pursuant to the agreement, the Corporation sold 7,500 shares of Senior Perpetual Preferred Stock, par value $1.00 per share, having a liquidation amount equal to $1,000.00 per share, with an attached warrant to purchase 50,111 shares of the Corporation's common stock, par value $1.25 per share, for the aggregate price of $7.5 million, to the U.S. Treasury.

The preferred stock qualifies as Tier 1 capital and will pay cumulative dividends at a rate of 5% per year, for the first five years, and 9% per year thereafter. Under the terms of the CPP, the preferred stock may be redeemed with the approval of the Federal Reserve in the first three years with the proceeds from the issuance of certain qualifying Tier 1 capital or after three years at par value plus accrued and unpaid dividends.

The warrant has a 10-year term with an exercise price equal to $22.45 per share of common stock.

Notes to Consolidated Financial Statements (continued)

4. Securities

The following table summarizes the Corporation’s securities as of December 31:

(Dollar amounts in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale:				
December 31, 2009:				
U.S. Treasury and federal agency	$ 2,976	$ 25	$ -	$ 3,001
U.S. government sponsored entities and agencies	50,953	113	(269)	50,797
Mortgage-backed securities: residential	16,459	109	(38)	16,530
Collateralized mortgage obligations	5,130	4	(4)	5,130
State and political subdivision	26,271	696	-	26,967
Equity securities	3,003	-	(185)	2,818
	$ 104,792	$ 947	$ (496)	$ 105,243
December 31, 2008:				
U.S. government sponsored entities and agencies	$ 19,985	$ 139	$ (47)	$ 20,077
Mortgage-backed securities: residential	16,672	546	-	17,218
Collateralized mortgage obligations	13,134	40	(12)	13,162
State and political subdivision	13,543	270	(5)	13,808
Corporate securities	3,984	-	-	3,984
Equity securities	3,893	-	(699)	3,194
	$ 71,211	$ 995	$ (763)	$ 71,443

Gains on sales of available for sale securities for the years ended December 31 were as follows:

(Dollar amounts in thousands)	2009	2008
Proceeds	$ 20,513	$ -
Gross gains	864	-
Tax provision related to gains	294	-

The following table summarizes scheduled maturities of the Corporation’s securities as of December 31, 2009:

(Dollar amounts in thousands)	Available for sale	
	Amortized Cost	Fair Value
Due in one year or less	$ 104	$ 105
Due after one year through five years	50,787	50,731
Due after five through ten years	19,921	20,255
Due after ten years	30,977	31,334

No scheduled maturity	3,003	2,818
	$ 104,792	$ 105,243

F-17

4. Securities (continued)

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

Securities with carrying values of $20.7 million and $13.0 million as of December 31, 2009 and 2008, respectively, were pledged to secure public deposits and for other purposes required or permitted by law.

Information pertaining to securities with gross unrealized losses at December 31, 2009 and 2008 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

(Dollar amounts in thousands)	Less than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
December 31, 2009:						
U.S. government sponsored entities and agencies	$ 32,716	$ (269)	$ -	$ -	$ 32,716	$ (269)
Mortgage-backed securities: residential	1,961	(38)	-	-	1,961	(38)
Collateralized mortgage obligations	1,275	(2)	910	(2)	2,185	(4)
Equity securities	1,341	(110)	686	(75)	2,027	(185)
	$ 37,293	$ (419)	$ 1,596	$ (77)	$ 38,889	$ (496)
December 31, 2008:						
U.S. government sponsored entities and agencies	$ 6,452	$ (47)	$ -	$ -	$ 6,452	$ (47)
Collateralized mortgage obligations	9,185	(12)	-	-	9,185	(12)
State and political subdivision	2,352	(5)	-	-	2,352	(5)
Equity securities	-	-	3,128	(699)	3,128	(699)
	$ 17,989	$ (64)	$ 3,128	$ (699)	$ 21,117	$ (763)

Management evaluates securities for OTTI at least on a quarterly basis, and more frequently when economic, market or other concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, (3) the intent of the Corporation to sell a security, and (4) whether it is more likely than not the Corporation will have to sell the security before recovery of its cost basis.

During 2009, after evaluation of the securities portfolio, management determined that other-than-temporary impairments existed on three financial institution equity securities. The impairment of these securities was considered to be other-than-temporary due to continued concerns related to the financial condition and near-term prospects of the issuers, economic conditions of the financial services industry and deteriorating market values. These securities were written down to their fair market values as of September 30, 2009 and the resulting impairment losses of $898,000 were recognized in earnings during the third quarter of 2009.

During 2008, management evaluated the Corporation's investment portfolio and determined that OTTI existed on Fannie Mae and Freddie Mac stocks. The impairment of these securities was considered to be other-than-temporary due to continued concerns related to the financial condition and near-term prospects of the issuers, economic conditions of the financial services industry and deteriorating market values. These securities were written down to their fair market value as of June 30, 2008 and again as of September 30, 2008. The resulting impairment losses of $391,000 were recognized in earnings during the second and third quarters of 2008.

4. Securities (continued)

The following table presents information related to the Corporation's gains and losses on the sales of equity and debt securities, and losses recognized for the OTTI of investments:

(Dollar amounts in thousands)	Gross Realized Gains	Gross Realized Losses	Other-than-temporary Impairment Losses	Net Gains (Losses)
Year ended December 31, 2009:				
Equity securities	$ -	$ -	$ (898)	$ (898)
Debt securities	864	-	-	864
	$ 864	$ -	$ (898)	$ (34)
Year ended December 31, 2008:				
Equity securities	$ -	$ -	$ (391)	$ (391)
Debt securities	-	-	-	-
	$ -	$ -	$ (391)	$ (391)

After realizing the impairment charges on the aforementioned equity securities, there were 33 debt securities and seven equity securities in an unrealized loss position as of December 31, 2009. For investments in equity securities, in addition to the general factors mentioned above for determining whether the decline in market value is other-than-temporary, the analysis of whether an equity security is other-than-temporarily impaired includes review of the profitability and the capital adequacy and all information available to determine the credit quality of each issuer. Based on that evaluation, and given that the Corporation's current intention is not to sell any impaired securities and it is more likely than not it will not be required to sell these securities before the recovery of its amortized cost basis, the Corporation does not consider those seven equity securities with unrealized losses as of December 31, 2009 to be other-than-temporarily impaired.

For debt securities, an additional and critical component of the evaluation for OTTI is the identification of credit impaired securities where it is likely that the Corporation will not receive cash flows sufficient to recover the entire amortized cost basis of the security. Based on that evaluation and other general considerations, and given that the Corporation's current intention is not to sell any impaired securities and it is more likely than not it will not be required to sell these securities before the recovery of its amortized cost basis, the Corporation does not consider those 33 debt securities with unrealized losses as of December 31, 2009 to be other-than-temporarily impaired.

Notes to Consolidated Financial Statements (continued)

5. Loans Receivable

The following table summarizes the Corporation’s loans receivable as of December 31:

(Dollar amounts in thousands)	2009	2008
Mortgage loans on real estate:		
Residential first mortgages	$ 74,099	$ 74,130
Home equity loans and lines of credit	77,284	57,454
Commercial real estate	89,952	85,689
	241,335	217,273
Other loans:		
Commercial business	41,588	40,787
Consumer	12,894	9,429
	54,482	50,216
Total loans, gross	295,817	267,489
Less allowance for loan losses	3,202	2,651
Total loans, net	$ 292,615	$ 264,838

Following is an analysis of the changes in the allowance for loan losses for the years ended December 31:

(Dollar amounts in thousands)	2009	2008
Balance at the beginning of the year	$ 2,651	$ 2,157
Allowance for loan losses of ECSLA	-	206
Provision for loan losses	1,367	500
Charge-offs	(859)	(252)
Recoveries	43	40
Balance at the end of the year	$ 3,202	$ 2,651

Non-performing loans, which include primarily non-accrual loans, were $2.4 million and $1.0 million at December 31, 2009 and 2008, respectively. The Corporation is not committed to lend significant additional funds to debtors whose loans are on non-accrual status. At December 31, 2009, the recorded investment in loans considered to be impaired was $740,000. Of the impaired loans at December 31, 2009, loans with a recorded investment of $590,000 required a specific valuation allowance of $128,000. During 2009, impaired loans averaged $533,000. The Corporation recognized interest income on impaired loans of approximately $71,000 on a cash basis, during 2009. The Corporation did not have any impaired loans during the year ending December 31, 2008. Nonperforming loans and impaired loans are defined differently. Some loans may be included in both categories whereas other loans may be included in only one category.

The Corporation is required to maintain qualifying collateral with the FHLB to secure all outstanding loans. Loans with book values of $135.4 million and $140.0 million as of December 31, 2009 and 2008, respectively, were pledged as qualifying collateral. The Corporation was in compliance with all FHLB credit policies at December 31, 2009.

F-20

Notes to Consolidated Financial Statements (continued)

5. Loans Receivable (continued)

The Corporation was servicing residential mortgage loans with unpaid principal balances of $6.7 million and $7.9 million at December 31, 2009 and 2008, respectively, for a third party investor. In addition, the Corporation was servicing commercial loans with unpaid principal balances of $2.7 million and $4.8 million at December 2009 and 2008, respectively, for third party investors. Such loans are not reflected in the consolidated balance sheet and servicing operations result in the generation of annual fee income of approximately 0.25% of the unpaid principal balances of such loans.

6. Federal Bank Stocks

The Bank is a member of the FHLB and the FRB. As a member of these federal banking systems, the Bank maintains an investment in the capital stock of the respective regional banks, at cost. These stocks are purchased and redeemed at par as directed by the federal banks and levels maintained are based primarily on borrowing and other correspondent relationships. The Bank's investment in FHLB and FRB stocks was $3.5 million and $662,000, respectively, at December 31, 2009, and $3.5 million and $333,000, respectively, at December 31, 2008. In December 2008, the FHLB notified member banks that it was suspending dividend payments and the repurchase of capital stock.

Management evaluated the FHLB capital stock for impairment in accordance with relevant accounting guidance. Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as: (1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB.

Management believes no impairment charge is necessary related to the FHLB capital stock as of December 31, 2009.

7. Premises and Equipment

Premises and equipment at December 31 are summarized by major classification as follows:

(Dollar amounts in thousands)	2009	2008
Land	$ 1,623	$ 1,403
Buildings and improvements	7,364	6,710
Leasehold improvements	750	744
Furniture, fixtures and equipment	5,056	4,757
Software	2,342	2,105
Construction in progress	537	714
	17,672	16,432
Less accumulated depreciation and amortization	8,502	7,823
	$ 9,170	$ 8,609

Notes to Consolidated Financial Statements (continued)

7. Premises and Equipment (continued)

Depreciation and amortization expense for the years ended December 31, 2009 and 2008 were $860,000 and $737,000, respectively.

Rent expense under non-cancelable operating lease agreements for the years ended December 31, 2009 and 2008 was $146,000 and $120,000, respectively. Rent commitments under non-cancelable long-term operating lease agreements for certain branch offices for the years ended December 31, are as follows, before considering renewal options that are generally present:

(Dollar amounts in thousands)	Amount
2010	$ 197
2011	172
2012	124
2013	96
2014	96
Thereafter	11
	$ 696

8. Goodwill and Intangible Assets

The following table summarizes the Corporation's acquired goodwill and intangible assets as of December 31:

(Dollar amounts in thousands)	2009		2008	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Goodwill	$ 3,657	$ -	$ 1,422	$ -
Core deposit intangibles	4,027	1,443	1,240	1,240
Other customer relationship intangibles	20	20	20	20
Total	$ 7,704	$ 1,463	$ 2,682	$ 1,260

As discussed in Note 2, the Bank completed a branch purchase transaction during the third quarter of 2009. In connection with the branch purchase, the Bank recorded initial goodwill of $2.2 million. After the initial goodwill was recorded, the Corporation recorded $23,000 of additional credit adjustments on certain loans acquired and adjusted the goodwill related to the branch purchase. Goodwill represents the excess of the total purchase price paid for the Titusville branch purchase over the fair value of the assets acquired, net of the fair value of the liabilities assumed. Goodwill is not amortized but is evaluated for impairment on an annual basis or whenever events or changes in circumstances indicate the carrying value may not be recoverable. No goodwill impairment charges were recorded in 2009.

Also, in connection with the assumption of deposits, the Bank recorded a core deposit intangible of $2.8 million. This intangible asset will be amortized using the double declining balance method over a weighted average estimated life of nine years. The core deposit intangible asset is not estimated to have a significant residual value. During 2009, the Corporation recorded intangible amortization expense totaling $203,000.

F-22

Notes to Consolidated Financial Statements (continued)

8. Goodwill and Intangible Assets (continued)

The estimated amortization expense of the core deposit intangible for the years ending December 31, are as follows:

(Dollar amounts in thousands)	Amortization Expense
2010	$ 564
2011	441
2012	345
2013	271
2014	217
Thereafter	746
	$ 2,584

9. Related Party Balances and Transactions

In the ordinary course of business, the Bank maintains loan and deposit relationships with employees, principal officers and directors. The Bank has granted loans to principal officers and directors and their affiliates amounting to $1.3 million and $1.1 million at December 31, 2009 and 2008, respectively. During 2009, total principal additions and total principal repayments associated with these loans were $379,000 and $156,000, respectively. Deposits from principal officers and directors held by the Bank at December 31, 2009 and 2008 totaled $2.3 million and $1.6 million, respectively.

In addition, directors and their affiliates may provide certain professional and other services to the Corporation and the Bank in the ordinary course of business at market fee rates. During 2009 and 2008, amounts paid to affiliates for such services totaled $51,000 and $174,000, respectively.

10. Deposits

The following table summarizes the Corporation's deposits as of December 31:

(Dollar amounts in thousands)	2009			2008		
Type of accounts	Weighted average rate	Amount	%	Weighted average rate	Amount	%
Non-interest bearing deposits	-	$ 67,033	17.4%	-	$ 56,351	19.7%
Interest bearing demand deposits	0.56%	154,085	40.0%	1.31%	106,042	37.0%
Time deposits	3.25%	164,207	42.6%	3.97%	124,254	43.3%
	1.61%	$ 385,325	100.0%	2.21%	$ 286,647	100.0%

The Corporation had a total of $49.3 million and $38.8 million in time deposits of $100,000 or more at December 31, 2009 and 2008, respectively.

Notes to Consolidated Financial Statements (continued)

10. Deposits (continued)

Scheduled maturities of time deposits for the next five years are as follows:

(Dollar amounts in thousands)	Amount	%
2010	$ 53,007	32.3%
2011	32,521	19.8%
2012	20,370	12.4%
2013	39,620	24.1%
2014	16,084	9.8%
Thereafter	2,604	1.6%
	$ 164,207	100.0%

11. Borrowed Funds

The following table summarizes the Corporation’s borrowed funds as of and for the year ended December 31:

(Dollar amounts in thousands)	2009				2008			
	Balance	Average Balance	Average Rate	Weighted average rate	Balance	Average Balance	Average Rate	Weighted average rate
Due within 12 months	$ 5,000	$ 15,611	2.69%	0.79%	$ 13,188	$ 10,096	2.20%	1.80%
Due beyond 12 months but within 5 years	15,000	15,000	4.13%	4.19%	15,000	15,000	4.13%	4.19%
Due beyond 5 years but within 10 years	20,000	20,000	4.64%	4.69%	20,000	20,000	4.64%	4.71%
	$ 40,000	$ 50,611			$ 48,188	$ 45,096		

Short-term borrowed funds at December 31, 2009 consisted of a $5.0 million advance on a line of credit with Atlantic Central Bankers Bank. The line of credit has an interest rate equal to the greater of 4.75% or prime plus 0.5%.

Long-term borrowed funds at December 31, 2009 consist of seven, $5.0 million term advances. The term advances mature between November 2011 and October 2017. If these advances convert to adjustable rate borrowings, the Corporation has the opportunity to repay the advances without penalty at or after the conversion date. All borrowings from the FHLB are secured by a blanket lien of qualified collateral.

The initial three $5.0 million borrowings have rates of 4.61%, 3.74% and 4.04%, respectively, although the rates may adjust quarterly at the option of the FHLB to the then three month LIBOR plus 20, 22 or 25 basis points, respectively, but only if the three month LIBOR exceeds 8.0%.

Notes to Consolidated Financial Statements (continued)

11. Borrowed Funds (continued)

In addition, the Corporation borrowed four additional $5.0 million 10 year term advances at initial interest rates of 4.98%, 4.83%,4.68% and 4.09%, respectively. Two of these borrowings are fixed for the first two years of the term after which the rates may adjust at the option of the FHLB to the then three month LIBOR rate plus 24 basis points. The third borrowing is also fixed for the first two years of the initial term after which the rates may adjust at the option of the FHLB to the then three month LIBOR plus 24 basis points, but only if the three month LIBOR exceeds 6.0%. The final borrowing is fixed for the first three years of the term after which the rates may adjust at the option of the FHLB to the then three month LIBOR rate plus 13 basis points.

Scheduled maturities of borrowed funds for the next five years are as follows:

(Dollar amounts in thousands)		Amount
2010	$	5,000
2011		5,000
2012		5,000
2013		5,000
2014		-
Thereafter		20,000
	$	40,000

The Bank maintains a credit arrangement with the FHLB as a source of additional liquidity. The total maximum borrowing capacity with the FHLB, excluding loans outstanding, at December 31, 2009 was $130.3 million. In addition, the Corporation has $500,000 and the Bank has $2.0 million of funds available on unused lines of credit through another correspondent bank.

12. Insurance of Accounts and Regulatory Matters

Insurance of Accounts

The deposits of the Bank have historically been insured by the Federal Deposit Insurance Corporation (FDIC) up to $100,000 per insured depositor, except certain types of retirement accounts, which are insured up to $250,000 per insured depositor. On October 3, 2008, the maximum amount insured under FDIC deposit insurance was temporarily increased from $100,000 to $250,000 per insured depositor through December 31, 2009. In May 2009, the FDIC extended this increased insurance level of $250,000 per depositor through December 31, 2013. After December 31, 2013, the standard insurance amount will return to $100,000 for all deposit categories except certain retirement accounts, which will continue to be insured up to $250,000 per insured depositor. To provide this insurance, the Bank must pay an annual premium and is required to maintain certain minimum levels of regulatory capital as outlined below.

Additionally, the Bank has elected to participate in the FDIC's Temporary Liquidity Guarantee Program. Under this program, all noninterest bearing deposit transaction accounts, lawyers' trust accounts and NOW accounts that pay interest rates equal to or less than 50 basis points and public funds held in noninterest bearing accounts with balances over $250,000 will also be fully insured through June 30, 2010.

Notes to Consolidated Financial Statements (continued)

12. Insurance of Accounts and Regulatory Matters (continued)

Restrictions on Dividends, Loans and Advances

The Bank is subject to a regulatory dividend restriction that generally limits the amount of dividends that can be paid by the Bank to the Corporation. Prior regulatory approval is required if the total of all dividends declared in any calendar year exceeds net profits (as defined in the regulations) for the year combined with net retained earnings (as defined) for the two preceding calendar years. In addition, dividends paid by the Bank to the Corporation would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements. As of December 31, 2009, $2.0 million of undistributed earnings of the Corporation was available for distribution of dividends without prior regulatory approval.

Loans or advances from the Bank to the Corporation are limited to 10% of the Bank's capital stock and surplus on a secured basis. Funds available for loans or advances by the Bank to the Corporation amounted to approximately $2.7 million. The Corporation has a $2.2 million commercial line of credit available at the Bank for the primary purpose of purchasing qualified equity investments. At December 31, 2009, the Corporation had an outstanding balance on this line of $1.1 million.

Minimum Regulatory Capital Requirements

The Corporation (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

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

As of December 31, 2009, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since the notification that management believes have changed the Bank's category.

Notes to Consolidated Financial Statements (continued)

12. Insurance of Accounts and Regulatory Matters (continued)

The following table sets forth certain information concerning regulatory capital of the consolidated Corporation and the Bank as of the dates presented:

(Dollar amounts in thousands)	December 31, 2009				December 31, 2008			
	Consolidated		Bank		Consolidated		Bank	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital to risk-weighted assets:								
Actual	$ 34,838	12.53%	$ 37,224	13.54%	$ 38,727	13.85%	$ 36,069	13.01%
For capital adequacy purposes	22,242	8.00%	21,987	8.00%	22,369	8.00%	22,174	8.00%
To be well capitalized	N/A	N/A	27,484	10.00%	N/A	N/A	27,718	10.00%
Tier 1 capital to risk-weighted assets:								
Actual	$ 31,636	11.38%	$ 34,022	12.38%	$ 36,386	13.01%	$ 33,422	12.06%
For capital adequacy purposes	11,121	4.00%	10,994	4.00%	11,184	4.00%	11,087	4.00%
To be well capitalized	N/A	N/A	16,491	6.00%	N/A	N/A	16,631	6.00%
Tier 1 capital to average assets:								
Actual	$ 31,636	6.91%	$ 34,022	7.48%	$ 36,386	10.88%	$ 33,422	9.21%
For capital adequacy purposes	18,320	4.00%	18,186	4.00%	13,382	4.00%	14,523	4.00%
To be well capitalized	N/A	N/A	22,732	5.00%	N/A	N/A	18,154	5.00%

13. Commitments and Legal Contingencies

In the ordinary course of business, the Corporation has various outstanding commitments and contingent liabilities that are not reflected in the accompanying consolidated financial statements. In addition, the Corporation is involved in certain claims and legal actions arising in the ordinary course of business. The outcome of these claims and actions are not presently determinable; however, in the opinion of the Corporation's management, after consulting legal counsel, the ultimate disposition of these matters will not have a material adverse effect on the consolidated financial statements.

14. Income Taxes

The Corporation and the Bank file a consolidated federal income tax return. The provision for income taxes for the years ended December 31 is comprised of the following:

(Dollar amounts in thousands)	2009	2008
Current	$ 344	$ 789
Deferred	(286)	(433)
	$ 58	$ 356

F-27

Notes to Consolidated Financial Statements (continued)

14. Income Taxes (continued)

A reconciliation between the provision for income taxes and the amount computed by multiplying operating results before income taxes by the statutory federal income tax rate of 34% for the years ended December 31 is as follows:

(Dollar amounts in thousands)	2009		2008	
	Amount	% Pre-tax Income	Amount	% Pre-tax Income
Provision at statutory tax rate	$ 543	34.0%	$ 947	34.0%
Increase (decrease) resulting from:				
Tax free interest, net of disallowance	(396)	(24.8)%	(270)	(9.7)%
Earnings on BOLI	(69)	(4.3)%	(68)	(2.4)%
Effect of extraordinary gain	-	0.0%	(308)	(11.1)%
Other, net	(20)	(1.3)%	55	2.0%
Provision	$ 58	3.6%	$ 356	12.8%

The tax effects of temporary differences between the financial reporting basis and income tax basis of assets and liabilities that are included in the net deferred tax asset as of December 31 relate to the following:

(Dollar amounts in thousands)	2009	2008
Deferred tax assets:		
Allowance for loan losses	$ 990	$ 848
Securities impairment	438	133
SFAS 158 pension accrual	376	633
Intangible assets	183	87
Other	104	6
Accrued pension cost	79	252
Stock options	77	49
Nonaccrual loan interest income	52	-
Accrued contract termination fees	-	122
Gross deferred tax assets	2,299	2,130
Deferred tax liabilities:		
	-	-
Depreciation	567	446
Stock gain	172	172
Net unrealized gains on securities	153	79
Prepaid expenses	123	91
Deferred loan fees	63	57
Purchase accounting adjustments	62	75
Loan servicing	14	20
Gross deferred tax liabilities	1,154	940
Net deferred tax asset	$ 1,145	$ 1,190

F-28

Notes to Consolidated Financial Statements (continued)

14. Income Taxes (continued)

In accordance with relevant accounting guidance, the Corporation determined that it was not required to establish a valuation allowance for deferred tax assets since it is more likely than not that the deferred tax asset will be realized through carry-back to taxable income in prior years, future reversals of existing taxable temporary differences, tax strategies and, to a lesser extent, future taxable income. The Corporation's net deferred tax asset is recorded in the consolidated financial statements as a component of other assets.

At December 31, 2009 and December 31, 2008, the Corporation had no unrecognized tax benefits recorded. The Corporation does not expect the total amount of unrecognized tax benefits to significantly increase within the next twelve months. The Corporation recognizes interest and penalties on unrecognized tax benefits in income taxes expense in its Consolidated Statements of Income.

The Corporation and the Bank are subject to U.S. federal income tax as well as a capital-based franchise tax in the Commonwealth of Pennsylvania. The Corporation and the Bank are no longer subject to examination by taxing authorities for years before 2006.

Notes to Consolidated Financial Statements (continued)

15. Employee Benefit Plans

Defined Benefit Plan

The Corporation provides pension benefits for eligible employees through a defined benefit pension plan. Substantially all employees participate in the retirement plan on a non-contributing basis, and are fully vested after three years of service. Effective January 1, 2009, the plan was closed to new participants. The Corporation uses December 31 as the measurement date for its plan. Information pertaining to changes in obligations and funded status of the defined benefit pension plan for the years ended December 31 is as follows:

(Dollar amounts in thousands)	2009	2008
Change in plan assets:		
Fair value of plan assets at beginning of year	$ 3,226	$ 3,883
Actual (loss) return on plan assets	673	(727)
Employer contribution	350	335
Benefits paid	(262)	(265)
Fair value of plan assets at end of year	3,987	3,226
Change in benefit obligation:		
Benefit obligation at beginning of year	5,115	4,508
Service cost	296	233
Interest cost	281	285
Actuarial loss	-	8
Effect of change in assumptions	(299)	346