EMCLAIRE FINANCIAL CORP
Form 10-K
March 23, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One):

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended: December 31, 2011

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from: to

Commission File Number: 000-18464

EMCLAIRE FINANCIAL CORP.

(Exact name of registrant as specified in its charter)

Pennsylvania	25-1606091

(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
612 Main Street, Emlenton, PA (Address of principal executive office)	16373 (Zip Code)

Registrant s telephone number: **(724) 867-2311**

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, par value $1.25 per share (Title of Class)	NASDAQ Capital Markets (NASDAQ) (Name of exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: **None.**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.Yes o No x.

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.Yes o No x.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.Yes x No o.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 month (or for such shorter period that the registrant was required to submit and post such files).Yes x No o.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).Yes o No x.

As of June 30, 2011, the aggregate value of the 1,489,239 shares of Common Stock of the Registrant issued and outstanding on such date, which excludes 258,169 shares held by the directors and officers of the Registrant as a group, was approximately $24.8 million. This figure is based on the last sales price of $16.62 per share of the Registrant s Common Stock on June 30, 2011. The number of outstanding shares of common stock as of March 23,

2012, was 1,751,908.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2012 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K.

TABLE OF CONTENTS

EMCLAIRE FINANCIAL CORP.

TABLE OF CONTENTS

PART I	
Item 1. Business	K-1
Item 1A. Risk Factors	K-18
Item 1B. Unresolved Staff Comments	K-18
Item 2. Properties	K-18
Item 3. Legal Proceedings	K-18
Item 4. Mine Safety Disclosures	K-18
PART II	
Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	K-19
Item 6. Selected Financial Data	K-19
Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations	K-20
Item 7A. Quantitative and Qualitative Disclosures About Market Risk	K-31
Item 8. Financial Statements and Supplementary Data	K-31
Item 9.	K-31

Changes in and Disagreements with Accountants on Accounting and Financial Disclosure
Item 9A.
K-31
Controls and Procedures
Item 9B.
K-32
Other Information
PART III
Item 10.
K-33
Directors, Executive Officers and Corporate Governance
Item 11.
K-33
Executive Compensation
Item 12.
K-33
Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters
Item 13.
K-33
Certain Relationships and Related Transactions, and Director Independence
Item 14.
K-33
Principal Accountant Fees and Services
PART IV
Item 15.
K-34
Exhibits and Financial Statement Schedules
SIGNATURES AND CERTIFICATIONS K-36

TABLE OF CONTENTS

Discussions of certain matters in this Form 10-K and other related year end documents may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), and as such, may involve risks and uncertainties. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies, and expectations, are generally identifiable by the use of words or phrases such as believe , plan , expect , intend , anticipate , estimate , project , forecast , may increase , may fluctuate , may improve and similar future or conditional verbs such as will , should , would , and could . These forward-looking statements relate to, am other things, expectations of the business environment in which the Corporation operates, projections of future performance, potential future credit experience, perceived opportunities in the market and statements regarding the Corporation s mission and vision. The Corporation s actual results, performance and achievements may differ materially from the results, performance, and achievements expressed or implied in such forward-looking statements due to a wide range of factors. These factors include, but are not limited to, changes in interest rates, general economic conditions, the local economy, the demand for the Corporation s products and services, accounting principles or guidelines, legislative and regulatory changes, monetary and fiscal policies of the U.S. Government, U.S. Treasury, and Federal Reserve, real estate markets, competition in the financial services industry, attracting and retaining key personnel, performance of new employees, regulatory actions, changes in and utilization of new technologies and other risks detailed in the Corporation s reports filed with the Securities and Exchange Commission (SEC) from time to time. These factors should be considered in evaluating the forward-looking statements, and undue reliance should not be placed on such statements. The Corporation does not undertake, and specifically disclaims any obligation, to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

PART I

Item 1. Business

General

Emclaire Financial Corp. (the Corporation) is a Pennsylvania corporation and financial holding company that provides a full range of retail and commercial financial products and services to customers in western Pennsylvania through its wholly owned subsidiary bank, The Farmers National Bank of Emlenton (the Bank). The Corporation also provides real estate settlement services through its subsidiary, Emclaire Settlement Services, LLC (the Title Company). In addition, the Bank provides investment advisory services through its Farmers National Financial Services division.

The Bank was organized in 1900 as a national banking association and is a financial intermediary whose principal business consists of attracting deposits from the general public and investing such funds in real estate loans secured by liens on residential and commercial property, consumer loans, commercial business loans, marketable securities and interest-earning deposits. The Bank operates through a network of thirteen retail branch offices in Venango, Butler, Clarion, Clearfield, Crawford, Elk, Jefferson and Mercer counties, Pennsylvania. The Corporation and the Bank are headquartered in Emlenton, Pennsylvania.

The Bank is subject to examination and comprehensive regulation by the Office of the Comptroller of the Currency (OCC), which is the Bank s chartering authority, and the Federal Deposit Insurance Corporation (FDIC), which insures customer deposits held by the Bank to the full extent provided by law. The Bank is a member of the Federal Reserve Bank of Cleveland (FRB) and the Federal Home Loan Bank of Pittsburgh (FHLB). The Corporation is a registered bank holding company pursuant to the Bank Holding Company Act of 1956, as amended (BHCA), and a financial

holding company under the Gramm-Leach Bliley Act of 1999 (GLBA).

At December 31, 2011, the Corporation had $491.9 million in total assets, $50.7 million in stockholders equity, $312.5 million in net loans and $416.5 million in deposits.

TABLE OF CONTENTS

Lending Activities

General. The principal lending activities of the Bank are the origination of residential mortgage, commercial mortgage, commercial business and consumer loans. Nearly all of the Bank s loans are originated in and secured by property within the Bank s primary market area.

One-to-Four Family Mortgage Loans. The Bank offers first mortgage loans secured by one-to-four family residences located mainly in the Bank s primary lending area. One-to-four family mortgage loans amounted to 29.6% of the total loan portfolio at December 31, 2011. Typically such residences are single-family owner occupied units. The Bank is an approved, qualified lender for the Federal Home Loan Mortgage Corporation (FHLMC). As a result, the Bank may sell loans to and service loans for the FHLMC in market conditions and circumstances where this is advantageous in managing interest rate risk.

Home Equity Loans. The Bank originates home equity loans secured by single-family residences. Home equity loans amounted to 22.5% of the total loan portfolio at December 31, 2011. These loans may be either a single advance fixed-rate loan with a term of up to 20 years, or a variable rate revolving line of credit. These loans are made only on owner-occupied single-family residences.

Commercial Business and Commercial Real Estate Loans. Commercial lending constitutes a significant portion of the Bank s lending activities. Commercial business and commercial real estate loans amounted to 43.9% of the total loan portfolio at December 31, 2011. Commercial real estate loans generally consist of loans granted for commercial purposes secured by commercial or other nonresidential real estate. Commercial loans consist of secured and unsecured loans for such items as capital assets, inventory, operations and other commercial purposes.

Consumer Loans. Consumer loans generally consist of fixed-rate term loans for automobile purchases, home improvements not secured by real estate, capital and other personal expenditures. The Bank also offers unsecured revolving personal lines of credit and overdraft protection. Consumer loans amounted to 4.0% of the total loan portfolio at December 31, 2011.

Loans to One Borrower. National banks are subject to limits on the amount of credit that they can extend to one borrower. Under current law, loans to one borrower are limited to an amount equal to 15% of unimpaired capital and surplus on an unsecured basis, and an additional amount equal to 10% of unimpaired capital and surplus if the loan is secured by readily marketable collateral. At December 31, 2011, the Bank s loans to one borrower limit based upon 15% of unimpaired capital was $6.8 million. The Bank may grant credit to borrowers in excess of the legal lending limit as part of the Legal Lending Limit Pilot Program approved by the OCC which allows the Bank to exceed its legal lending limit within certain parameters. At December 31, 2011, the Bank s largest single lending relationship had an outstanding balance of $6.8 million. The Bank s next largest single lending relationship had an outstanding balance of $5.6 million. These loans were performing in accordance with their loan terms at December 31, 2011.

TABLE OF CONTENTS

Loan Portfolio. The following table sets forth the composition and percentage of the Corporation s loans receivable in dollar amounts and in percentages of the portfolio as of December 31:

(Dollar amounts in thousands)	2011 Dollar Amount	%	2010 Dollar Amount	%	2009 Dollar Amount	%	2008 Dollar Amount	%	2007 Dollar Amount	%
Mortgage loans on real estate:										
Residential first mortgages	$93,610	29.6 %	$84,575	27.3 %	$74,099	25.0 %	$74,130	27.7 %	$65,706	28.3 %
Home equity loans and lines of credit	71,238	22.5 %	75,458	24.3 %	77,284	26.1 %	57,454	21.5 %	49,426	21.3 %
Commercial	94,765	30.0 %	93,028	30.0 %	89,952	30.4 %	85,689	32.1 %	71,599	30.9 %
Total real estate loans	259,613	82.1 %	253,061	81.6 %	241,335	81.5 %	217,273	81.3 %	186,731	80.5 %
Other loans:										
Commercial business	43,826	13.9 %	43,780	14.1 %	41,588	14.1 %	40,787	15.2 %	35,566	15.3 %
Consumer	12,642	4.0 %	13,443	4.3 %	12,894	4.4 %	9,429	3.5 %	9,679	4.2 %
Total other loans	56,468	17.9 %	57,223	18.4 %	54,482	18.5 %	50,216	18.7 %	45,245	19.5 %
Total loans receivable	316,081	100.0%	310,284	100.0%	295,817	100.0%	267,489	100.0%	231,976	100.0%
Less:										
Allowance for loan losses	3,536		4,132		3,202		2,651		2,157	
Net loans receivable	$312,545		$306,152		$292,615		$264,838		$229,819	

The following table sets forth the final maturity of loans in the Corporation s portfolio as of December 31, 2011. Demand loans having no stated schedule of repayment and no stated maturity are reported as due within one year.

(Dollar amounts in thousands)	Due in one year or less	Due from one to five years	Due from five to ten years	Due after ten years	Total
Residential mortgages	$ 800	$ 1,962	$ 10,000	$ 80,848	$93,610
Home equity loans and lines of credit	828	4,976	24,015	41,419	71,238
Commercial mortgages	942	4,562	18,402	70,859	94,765
Commercial business	2,914	7,885	3,798	29,229	43,826
Consumer	444	6,328	1,191	4,679	12,642
	$ 5,928	$ 25,713	$ 57,406	$ 227,034	$316,081

The following table sets forth the dollar amount of the Corporation s fixed and adjustable rate loans with maturities greater than one year as of December 31, 2011:

(Dollar amounts in thousands)	Fixed rates	Adjustable rates
Residential mortgage	$ 77,500	$ 15,310
Home equity loans and lines of credit	56,332	14,078
Commercial mortgage	14,318	79,505
Commercial business	22,523	18,389

Consumer	7,399	4,799
	$ 178,072	$ 132,081

Contractual maturities of loans do not reflect the actual term of the Corporation s loan portfolio. The average life of mortgage loans is substantially less than their contractual terms because of loan prepayments and enforcement of due-on-sale clauses, which give the Corporation the right to declare a loan immediately payable in the event, among other things, that the borrower sells the real property subject to the mortgage. Scheduled principal amortization also reduces the average life of the loan portfolio. The average life of mortgage loans tends to increase when current market mortgage rates substantially exceed rates on existing mortgages and conversely, decrease when rates on existing mortgages substantially exceed current market interest rates.

Delinquencies and Classified Assets

Delinquent Loans and Other Real Estate Acquired Through Foreclosure (OREO). Typically, a loan is considered past due and a late charge is assessed when the borrower has not made a payment within fifteen

TABLE OF CONTENTS

days from the payment due date. When a borrower fails to make a required payment on a loan, the Corporation attempts to cure the deficiency by contacting the borrower. The initial contact with the borrower is made shortly after the seventeenth day following the due date for which a payment was not received. In most cases, delinquencies are cured promptly.

If the delinquency exceeds 60 days, the Corporation works with the borrower to set up a satisfactory repayment schedule. Typically, loans are considered non-accruing upon reaching 90 days delinquent, although the Corporation may be receiving partial payments of interest and partial repayments of principal on such loans. When a loan is placed in non-accrual status, previously accrued but unpaid interest is deducted from interest income. The Corporation institutes foreclosure action on secured loans only if all other remedies have been exhausted. If an action to foreclose is instituted and the loan is not reinstated or paid in full, the property is sold at a judicial or trustee s sale at which the Corporation may be the buyer.

Real estate properties acquired through, or in lieu of, foreclosure are to be sold and are initially recorded at fair value at the date of foreclosure less costs to sell, thereby establishing a new cost basis. After foreclosure, management periodically performs valuations and the real estate is carried at the lower of carrying amount or fair value less the cost to sell the property. Revenue and expenses from operations and changes in the valuation allowance are included in loss on foreclosed real estate. The Corporation generally attempts to sell its OREO properties as soon as practical upon receipt of clear title.

As of December 31, 2011, the Corporation s non-performing assets amounted to $5.9 million or 1.19% of the Corporation s total assets compared to $7.0 million or 1.45% of the Corporation s total assets at December 31, 2010. Non-performing assets at December 31, 2011 included non-accrual loans, loans past due 90 days and OREO of $5.5 million, $66,000 and $307,000, respectively. Included in non-accrual loans at December 31, 2011 were eight loans totaling $794,000 considered to be troubled debt restructurings. Interest income of $432,000 would have been recorded in 2011 if the nonaccrual loans had been current and performing during the entire period. Interest of $310,000 on these loans was included in income during 2011.

Classified Assets. Regulations applicable to insured institutions require the classification of problem assets as substandard, doubtful, or loss depending upon the existence of certain characteristics as discussed below. A category designated special mention must also be maintained for assets currently not requiring the above classifications but having potential weakness or risk characteristics that could result in future problems. An asset is classified as substandard if not adequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. A substandard asset is characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all the weaknesses inherent in those classified as substandard. In addition, these weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable or improbable. Assets classified as loss are considered uncollectible and of such little value that their continuance as assets is not warranted.

The Corporation s classification of assets policy requires the establishment of valuation allowances for loan losses in an amount deemed prudent by management. Valuation allowances represent loss allowances that have been established to recognize the inherent risk associated with lending activities. When the Corporation classifies a problem asset as a loss, the portion of the asset deemed uncollectible is charged off immediately.

The Corporation regularly reviews the problem loans and other assets in its portfolio to determine whether any require classification in accordance with the Corporation s policy and applicable regulations. As of December 31, 2011, the Corporation s classified and criticized assets amounted to $11.8 million or 2.4% of total assets, with $7.3 million classified as substandard and $4.5 million identified as special mention.

Included in classified and criticized assets at December 31, 2011 are two large loans exhibiting credit deterioration impacting the ability of the borrowers to comply with their present loan repayment terms on a timely basis.

The first loan, with an outstanding balance of $2.9 million at December 31, 2011, was originated for the construction of a hotel, restaurant and retail plaza secured by such property, the borrower s personal residence, a separate residence and a separate farm. The hotel, restaurant and retail plaza are complete and operational. However, cash flows from operations have not been consistent and are impacted by the seasonal nature of the

TABLE OF CONTENTS

hotel. In addition, the borrower does not have other liquid sources of cash flow. As a result, the borrower has listed substantial real estate holdings for sale. At December 31, 2011, the loan was current but identified as special mention. Ultimately, due to the estimated value of the borrower s significant real estate holdings, the Bank does not currently expect to incur a loss on this loan.

The second loan, with an outstanding balance of $2.1 million at December 31, 2011, is a consumer installment loan for the purpose of consolidating various personal debts. This loan is secured by a lien on the primary residence of the borrower discussed above, an assigned life insurance policy and the assignment of patent royalty income. Due to business difficulties and decreased royalty income, payments on the loan have not always been timely. At December 31, 2011, the loan was non-performing and classified as substandard. As a result of the estimated value of the lien on the property owned by the first borrower, the estimated cash flow of royalty income and the borrower s business prospects, the Bank does not currently expect to incur a loss on this loan.

The following table sets forth information regarding the Corporation s non-performing assets as of December 31:

(Dollar amounts in thousands)	2011	2010	2009	2008	2007
Non-performing loans	$5,565	$6,611	$2,418	$1,011	$952
Total as a percentage of gross loans	1.76 %	2.13 %	0.82 %	0.38 %	0.41 %
Repossessions			40		
Real estate acquired through foreclosure	307	373	173	50	129
Total as a percentage of total assets	0.06 %	0.08 %	0.05 %	0.01 %	0.04 %
Total non-performing assets	$5,872	$6,984	$2,631	$1,061	$1,081
Total non-performing assets as a percentage of total assets	1.19 %	1.45 %	0.56 %	0.28 %	0.35 %
Allowance for loan losses as a percentage of non-performing loans	63.54%	62.50%	132.42%	262.22%	226.58%

Allowance for Loan Losses. Management establishes allowances for estimated losses on loans based upon its evaluation of the pertinent factors underlying the types and quality of loans; historical loss experience based on volume and types of loans; trend in portfolio volume and composition; level and trend on non-performing assets; detailed analysis of individual loans for which full collectability may not be assured; determination of the existence and realizable value of the collateral and guarantees securing such loans and the current economic conditions affecting the collectability of loans in the portfolio. The Corporation analyzes its loan portfolio at least quarterly for valuation purposes and to determine the adequacy of its allowance for losses. Based upon the factors discussed above, management believes that the Corporation s allowance for losses as of December 31, 2011 of $3.5 million was adequate to cover probable incurred losses in the portfolio at such time.

TABLE OF CONTENTS

The following table sets forth an analysis of the allowance for losses on loans receivable for the years ended December 31:

(Dollar amounts in thousands)	2011	2010	2009	2008	2007
Balance at beginning of period	$4,132	$3,202	$2,651	$2,157	$2,035
Provision for loan losses	420	1,306	1,367	500	256
Allowance for loan losses of ECSLA				206	
Charge-offs:					
Residential mortgage loans	(224)	(40)	(35)	(10)	(48)
Home equity loans and lines of credit	(188)	(45)			
Commercial mortgage loans	(200)	(61)	(477)	(82)	(34)
Commercial business loans	(415)	(216)	(264)		(22)
Consumer loans	(67)	(190)	(83)	(160)	(60)
	(1,094)	(552)	(859)	(252)	(164)
Recoveries:					
Residential mortgage loans	3	2			1
Home equity loans and lines of credit	1	2			
Commercial mortgage loans		147			
Commercial business loans	63	5	7	15	16
Consumer loans	11	20	36	25	13
	78	176	43	40	30
Net charge-offs	(1,016)	(376)	(816)	(212)	(134)
Balance at end of period	$3,536	$4,132	$3,202	$2,651	$2,157
Ratio of net charge-offs to average loans outstanding	0.32%	0.12%	0.29%	0.08%	0.06%
Ratio of allowance to total loans at end of period	1.12%	1.33%	1.08%	0.99%	0.93%

The following table provides a breakdown of the allowance for loan losses by major loan category for the years ended December 31:

	2011		2010		2009		2008		2007	
(Dollar amounts in thousands) **Loan Categories:**	Dollar Amount	Percent of loans in each category to total loans	Dollar Amount	Percent of loans in each category to total loans	Dollar Amount	Percent of loans in each category to total loans	Dollar Amount	Percent of loans in each category to total loans	Dollar Amount	Percent of loans in each category to total loans
Commercial, financial and agricultural	$590	13.9%	$1,323	14.1%	$448	14.1%	$431	15.2%	$387	15.3%
Commercial mortgages	1,737	30.0%	1,707	30.0%	1,891	30.4%	1,369	32.1%	1,068	30.9%
Residential mortgages	832	29.6%	398	27.3%	356	25.0%	363	27.7%	309	28.3%
	320	22.5%	572	24.3%	452	26.1%	467	21.5%	368	21.3%

Home equity loans										
Consumer loans	57	4.0 %	132	4.3 %	51	4.4 %	73	3.5 %	79	4.2 %
Unallocated					4		(52)		(54)	
	$3,536	100 %	$4,132	100 %	$3,202	100 %	$2,651	100 %	$2,157	100 %

Investment Activities

General. The Corporation maintains an investment portfolio of securities such as U.S. government agencies, mortgage-backed securities, municipal and equity securities.

Investment decisions are made within policy guidelines established by the Board of Directors. This policy is aimed at maintaining a diversified investment portfolio, which complements the overall asset/liability and liquidity objectives of the Bank, while limiting the related credit risk to an acceptable level.

TABLE OF CONTENTS

The following table sets forth certain information regarding the fair value, weighted average yields and contractual maturities of the Corporation s securities as of December 31, 2011:

(Dollar amounts in thousands)	Due in 1 year or less	Due from 1 to 3 years	Due from 3 to 5 years	Due from 5 to 10 years	Due after 10 years	No scheduled maturity	Total
U.S. Treasury and federal agency	$	$	$	$3,822	$638	$	$4,460
U.S. government sponsored entities and agencies			33,515	8,005			41,520
Mortgage-backed securities: residential		166	3	1	37,308		37,478
State and political subdivision		1,152	4,114	27,143	4,591		37,000
Equity securities						2,696	2,696
Estimated fair value	$	$1,318	$37,632	$38,971	$42,537	$2,696	$123,154
Weighted average yield(1)	0.00%	4.56 %	2.05 %	4.10 %	3.90 %	3.04 %	3.39 %

(1) Taxable equivalent adjustments have been made in calculating yields on state and political subdivision securities.

The following table sets forth the fair value of the Corporation s investment securities as of December 31:

(Dollar amounts in thousands)	2011	2010	2009
U.S. Treasury and federal agency	$ 4,460	$ 6,729	$ 3,001
U.S. government sponsored entities and agencies	41,520	62,362	50,797
Mortgage-backed securities: residential	37,478	19,380	16,530
Collateralized mortgage obligations		922	5,130
State and political subdivision	37,000	33,902	26,967
Equity securities	2,696	2,525	2,818
	$ 123,154	$ 125,820	$ 105,243

For additional information regarding the Corporation s investment portfolio see Note 4 Securities on page F-14 to the consolidated financial statements.

Sources of Funds

General. Deposits are the primary source of the Bank s funds for lending and investing activities. Secondary sources of funds are derived from loan repayments, investment maturities and borrowed funds. Loan repayments can be considered a relatively stable funding source, while deposit activity is greatly influenced by interest rates and general market conditions. The Bank also has access to funds through other various sources. For a description of the Bank s sources of funds, see Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity in item 7.

Deposits. The Bank offers a wide variety of retail deposit account products to both consumer and commercial deposit customers, including time deposits, non-interest bearing and interest bearing demand deposit accounts, savings deposits and money market accounts.

Deposit products are promoted in periodic newspaper and radio advertisements, along with notices provided in customer account statements. The Bank s marketing strategy is based on its reputation as a community bank that provides quality products and personalized customer service.

The Bank pays interest rates on its interest bearing deposit products that are competitive with rates offered by other financial institutions in its market area. Management reviews interest rates on deposits weekly and considers a number of factors, including: (1) the Bank s internal cost of funds; (2) rates offered by competing financial institutions; (3) investing and lending opportunities; and (4) the Bank s liquidity position.

TABLE OF CONTENTS

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

(Dollar amounts in thousands) **Type of accounts**	2011 Weighted average rate	Amount	%	2010 Weighted average rate	Amount	%
Non-interest bearing deposits		$ 84,871	20.4 %		$ 75,941	18.5 %
Interest bearing demand deposits	0.19 %	186,107	44.7 %	0.28 %	188,910	46.1 %
Time deposits	2.98 %	145,490	34.9 %	3.25 %	144,807	35.4 %
	1.13 %	$ 416,468	100.0 %	1.28 %	$ 409,658	100.0 %

The following table sets forth maturities of the Corporation s certificates of deposit of $100,000 or more at December 31, 2011 by time remaining to maturity:

(Dollar amounts in thousands)	Amount
Less than three months	$ 2,397
Over three months to six months	5,468
Over six months to twelve months	5,116
Over twelve months	41,478
	$ 54,459

Borrowings. Borrowings may be used to compensate for reductions in deposit inflows or net deposit outflows, or to support lending and investment activities. These borrowings include FHLB advances, federal funds, repurchase agreements, advances from the Federal Reserve Discount Window and lines of credit at the Bank and the Corporation with other correspondent banks. The following table summarizes information with respect to borrowings at or for the years ending December 31:

(Dollar amounts in thousands)	2011	2010
Ending balance	$ 20,000	$ 30,000
Average balance	25,482	36,488
Maximum balance	30,000	40,000
Average rate	4.65 %	4.56 %

For additional information regarding the Corporation s deposit base and borrowed funds, see Management s Discussion and Analysis of Financial Condition and Results of Operations Deposits and Borrowed Funds in item 7 and Note 10 Deposits on page F-24 and Note 11 Borrowed Funds on page F-25 to the consolidated financial statements.

Subsidiary Activity

The Corporation has two wholly owned subsidiaries, the Bank and the Title Company. As of December 31, 2011, the Bank and the Title Company had no subsidiaries.

Personnel

At December 31, 2011, the Bank had 118 full time equivalent employees. There is no collective bargaining agreement between the Bank and its employees, and the Bank believes its relationship with its employees to be satisfactory.

Competition

The Bank competes for loans, deposits and customers with other commercial banks, savings and loan associations, securities and brokerage companies, mortgage companies, insurance companies, finance companies, money market funds, credit unions and other nonbank financial service providers.

Supervision and Regulation

General. Bank holding companies and banks are extensively regulated under both federal and state law. Set forth below is a summary description of certain provisions of certain laws that relate to the regulation of the Corporation and the Bank. The description does not purport to be complete and is qualified in its entirety by reference to the applicable laws and regulations.

TABLE OF CONTENTS

The Corporation. The Corporation is a registered bank holding company, and subject to regulation and examination by the FRB under the BHCA and a financial holding company under the GLBA. The Corporation is required to file with the FRB periodic reports and such additional information as the FRB may require. Recent changes to the Bank Holding Company rating system emphasizes risk management and evaluation of the potential impact of non-depository entities on safety and soundness.

The FRB may require the Corporation to terminate an activity or terminate control of or liquidate or divest certain subsidiaries, affiliates or investments when the FRB believes the activity or the control of the subsidiary or affiliate constitutes a significant risk to the financial safety, soundness or stability of any of its banking subsidiaries. The FRB also has the authority to regulate provisions of certain bank holding company debt, including the authority to impose interest ceilings and reserve requirements on such debt. Under certain circumstances, the Corporation must file written notice and obtain FRB approval prior to purchasing or redeeming its equity securities.

Further, the Corporation is required by the FRB to maintain certain levels of capital. See Capital Standards.

The Corporation is required to obtain prior FRB approval for the acquisition of more than 5% of the outstanding shares of any class of voting securities or substantially all of the assets of any bank or bank holding company. Prior FRB approval is also required for the merger or consolidation of the Corporation and another bank holding company.

The BHCA generally prohibits a bank holding company from acquiring direct or indirect ownership or control of more than 5% of the outstanding voting shares of any company that is not a bank or bank holding company and from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or furnishing services to its subsidiaries. However, subject to the prior FRB approval, a bank holding company may engage in any, or acquire shares of companies engaged in, activities that the FRB deems to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

The GLBA amended portions of the BHCA to authorize bank holding companies to engage in securities, insurance and other activities that are financial in nature or incidental to a financial activity. In order to undertake these activities, a bank holding company must become a financial holding company by submitting to the appropriate FRB a declaration that the company elects to be a financial holding company and a certification that all of the depository institutions controlled by the company are well capitalized and well managed. The Corporation submitted the declaration of election to become a financial holding company with the FRB of Cleveland in February 2007, and the election became effective in March 2007.

Under FRB regulations, the Corporation is required to serve as a source of financial and managerial strength to the Bank and may not conduct operations in an unsafe or unsound manner. In addition, it is the FRB s policy that a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company s failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the FRB to be an unsafe and unsound banking practice or a violation of FRB regulations or both.

The Corporation is also a bank holding company within the meaning of the Pennsylvania Banking Code. As such, the Corporation and its subsidiaries are subject to examination by, and may be required to file reports with, the Pennsylvania Department of Banking.

The Corporation s securities are registered with the SEC under the Exchange Act. As such, the Corporation is subject to the information, proxy solicitation, insider trading, corporate governance, and other requirements and restrictions of

the Exchange Act. The public may obtain all forms and information filed with the SEC through their website *http://www.sec.gov.*

The Bank. As a national banking association, the Bank is subject to primary supervision, examination and regulation by the OCC. The Bank is also subject to regulations of the FDIC as administrator of the Deposit Insurance Fund (DIF) and the FRB. If, as a result of an examination of the Bank, the OCC should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other

TABLE OF CONTENTS

aspects of the Bank s operations are unsatisfactory or that the Bank is violating or has violated any law or regulation, various remedies are available to the OCC. Such remedies include the power to enjoin unsafe or unsound practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in capital, to restrict the Bank s growth, to assess civil monetary penalties, and to remove officers and directors. The FDIC has similar enforcement authority, in addition to its authority to terminate the Bank s deposit insurance in the absence of action by the OCC and upon a finding that the Bank is operating in an unsafe or unsound condition, is engaging in unsafe or unsound activities, or that the Bank s conduct poses a risk to the deposit insurance fund or may prejudice the interest of its depositors.

A national bank may have a financial subsidiary engaged in any activity authorized for national banks directly or certain permissible activities. Generally, a financial subsidiary is permitted to engage in activities that are financial in nature or incidental thereto, even though they are not permissible for the national bank itself. The definition of financial in nature includes, among other items, underwriting, dealing in or making a market in securities, including, for example, distributing shares of mutual funds. The subsidiary may not, however, engage as principal in underwriting insurance, issue annuities or engage in real estate development or investment or merchant banking.

The Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 addresses accounting oversight and corporate governance matters, including:

The prohibition of accounting firms from providing various types of consulting services to public clients and requiring accounting firms to rotate partners among public client assignments every five years;

Increased penalties for financial crimes and forfeiture of executive bonuses in certain circumstances;

Required executive certification of financial presentations;

Increased requirements for board audit committees and their members;

Enhanced disclosure of controls and procedures and internal control over financial reporting;

Enhanced controls on, and reporting of, insider trading; and

Statutory separations between investment bankers and analysts.

The new legislation and its implementing regulations have resulted in increased costs of compliance, including certain outside professional costs. To date these costs have not had a material impact on the Corporation s operations.

The Dodd-Frank Wall Street Reform and Consumer Protection Act. On July 21, 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act. The financial reform and consumer protection act imposes new restrictions and an expanded framework of regulatory oversight for financial institutions, including depository institutions, and changes the jurisdictions of existing bank regulatory agencies. The new law also establishes an independent federal consumer protection bureau within the Federal Reserve. The following discussion summarizes significant aspects of the new law. Although a significant number of the rules and regulations mandated by the Dodd-Frank Act have been finalized, many of the new requirements called for have yet to be implemented and will likely be subject to implementing regulations over the course of several years. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies, the full extent of the impact such requirements will have on financial institutions operations is unclear.

The following aspects of the financial reform and consumer protection act are related to the operations of the Bank:

A new independent consumer financial protection bureau has been established within the Federal Reserve, empowered to exercise broad regulatory, supervisory and enforcement authority with respect to both new and existing consumer financial protection laws. Smaller financial institutions,

TABLE OF CONTENTS

like the Bank, are subject to the supervision and enforcement of their primary federal banking regulator with respect to the federal consumer financial protection laws.

The Federal Deposit Insurance Act was amended to direct federal regulators to require depository institution holding companies to serve as a source of strength for their depository institution subsidiaries.

Tier 1 capital treatment for hybrid capital items like trust preferred securities has been eliminated subject to various grandfathering and transition rules.

The current prohibition on payment of interest on demand deposits was repealed, effective July 21, 2011, thereby permitting depository institutions to pay interest on business transaction and other accounts.

State law is preempted only if it would have a discriminatory effect on a federal savings association or is preempted by any other federal law. The OCC must make a preemption determination on a case-by-case basis with respect to a particular state law or other state law with substantively equivalent terms.

Deposit insurance was permanently increased to $250,000 and unlimited deposit insurance for noninterest-bearing transaction accounts extended through the end of 2012.

Deposit insurance assessment base calculation now equals the depository institution s total assets minus the sum of its average tangible equity during the assessment period.

The minimum reserve ratio of the DIF increased to 1.35% of estimated annual insured deposits or assessment base; however, the FDIC is directed to offset the effect of the increased reserve ratio for insured depository institutions with total consolidated assets of less than $10 billion.

The following aspects of the financial reform and consumer protection act are related to the operations of the Corporation:

The SEC is authorized to adopt rules requiring public companies to make their proxy materials available to shareholders for nomination of their own candidates for election to the board of directors.

Public companies are required to provide their shareholders with a non-binding vote: (i) at least once every three years on the compensation paid to executive officers, and (ii) at least once every six years on whether they should have a say on pay vote every one, two or three years.

A separate, non-binding shareholder vote is required regarding golden parachutes for named executive officers when a shareholder vote takes place on mergers, acquisitions, dispositions or other transactions that would trigger the parachute payments.

Securities exchanges are now required to prohibit brokers from using their own discretion to vote shares not beneficially owned by them for certain significant matters, which include votes on the election of directors, executive compensation matters, and any other matter determined to be significant.

Stock exchanges will be prohibited from listing the securities of any issuer that does not have a policy providing for (i) disclosure of its policy on incentive compensation payable on the basis of financial information reportable under the securities laws, and (ii) the recovery from current or former executive officers, following an accounting restatement triggered by material noncompliance with securities law reporting requirements, of any incentive compensation paid erroneously during the three-year period preceding the date on which the restatement was required that exceeds the amount that would have been paid on the basis of the restated financial information.

Disclosure in annual proxy materials will be required concerning the relationship between the executive compensation paid and the financial performance of the issuer.

TABLE OF CONTENTS

Item 402 of Regulation S-K will be amended to require companies to disclose the ratio of the Chief Executive Officer s annual total compensation to the median annual total compensation of all other employees.
Smaller reporting companies are exempt from complying with the internal control over financial reporting auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act.

Anti-Money Laundering. All financial institutions, including national banks, are subject to federal laws that are designed to prevent the use of the U.S. financial system to fund terrorist activities. Financial institutions operating in the United States must develop anti-money laundering compliance programs, due diligence policies and controls to ensure the detection and reporting of money laundering. Such compliance programs are intended to supplement compliance requirements, also applicable to financial institutions, under the Bank Secrecy Act and the Office of Foreign Assets Control Regulations. The Bank has established policies and procedures to ensure compliance with these provisions.

Privacy. Federal banking rules limit the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. Pursuant to these rules, financial institutions must provide:

Initial notices to customers about their privacy policies, describing the conditions under which they may disclose nonpublic personal information to nonaffiliated third parties and affiliates;

Annual notices of their privacy policies to current customers; and

A reasonable method for customers to opt out of disclosures to nonaffiliated third parties.

These privacy provisions affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. The Corporation s privacy policies have been implemented in accordance with the law.

Dividends and Other Transfers of Funds. Dividends from the Bank constitute the principal source of income to the Corporation. The Corporation is a legal entity separate and distinct from the Bank. The Bank is subject to various statutory and regulatory restrictions on its ability to pay dividends to the Corporation. In addition, the Bank s regulators have the authority to prohibit the Bank from paying dividends, depending upon the Bank s financial condition, if such payment is deemed to constitute an unsafe or unsound practice.

Limitations on Transactions with Affiliates. Transactions between national banks and any affiliate are governed by Sections 23A and 23B of the Federal Reserve Act. An affiliate of a national bank includes any company or entity which controls the national bank or that is controlled by a company that controls the national bank. In a holding company context, the holding company of a national bank (such as the Corporation) and any companies which are controlled by such holding company are affiliates of the national bank. Generally, Section 23A limits the extent to which the national bank of its subsidiaries may engage in covered transactions with any one affiliate to an amount equal to 10% of such bank s capital stock and surplus, and contains an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus. Section 23B applies to covered transactions as well as certain other transactions and requires that all transactions be on terms substantially the same, or at least favorable, to the national bank as those provided to a non-affiliate. The term covered transaction includes the making of loans to, purchase of assets from and issuance of a guarantee to an affiliate and similar transactions. Section 23B transactions also include the provision of services and the sale of assets by a national bank to an affiliate.

In addition, Sections 22(g) and (h) of the Federal Reserve Act place restrictions on loans to executive officers, directors and principal shareholders of the national bank and its affiliates. Under Section 22(h), loans to a director, an executive officer and to a greater than 10% shareholder of a national bank, and certain affiliated interests of either, may not exceed, together with all other outstanding loans to such person and affiliated interests, the national bank s loans to one borrower limit (generally equal to 15% of the bank s unimpaired capital and surplus). Section 22(h) also requires that loans to directors, executive officers and principal shareholders be made on terms substantially the same as offered in comparable transactions to other persons unless the loans are made pursuant to a benefit or compensation

program that (i) is widely available to

K-12

TABLE OF CONTENTS

employees of the bank and (ii) does not give preference to any director, executive officer or principal shareholder, or certain affiliated interests of either, over other employees of the national bank. Section 22(h) also requires prior board approval for certain loans. In addition, the aggregate amount of extensions of credit by a national bank to all insiders cannot exceed the bank s unimpaired capital and surplus. Furthermore, Section 22(g) places additional restrictions on loans to executive officers. The Bank currently is subject to Section 22(g) and (h) of the Federal Reserve Act and at December 31, 2011, was in compliance with the above restrictions.

Loans to One Borrower Limitations. With certain limited exceptions, the maximum amount that a national bank may lend to any borrower (including certain related entities of the borrower) at one time may not exceed 15% of the unimpaired capital and surplus of the institution, plus an additional 10% of unimpaired capital and surplus for loans fully secured by readily marketable collateral. At December 31, 2011, the Bank s loans-to-one-borrower limit was $6.8 million based upon the 15% of unimpaired capital and surplus measurement. The Bank may grant credit to borrowers in excess of the legal lending limit as part of the Legal Lending Limit Pilot Program approved by the OCC which allows the Bank to exceed its legal lending limit within certain parameters. At December 31, 2011, the Bank s largest single lending relationship had an outstanding balance of $6.8 million. The Bank s next largest single lending relationship had an outstanding balance of $5.6 million at December 31, 2011.

Capital Standards. The federal banking agencies have adopted risk-based minimum capital guidelines intended to provide a measure of capital that reflects the degree of risk associated with a banking organization s operations for both transactions reported on the balance sheet as assets and transactions which are recorded as off-balance sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off-balance sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as federal banking agencies, to 100% for assets with relatively high credit risk.

The risk-based capital ratio is determined by classifying assets and certain off-balance sheet financial instruments into weighted categories, with higher levels of capital being required for those categories perceived as representing greater risk. Under the capital guidelines, a banking organization s total capital is divided into tiers. Tier I capital consists of (1) common equity, (2) qualifying noncumulative perpetual preferred stock, (3) a limited amount of qualifying cumulative perpetual preferred stock and (4) minority interests in the equity accounts of consolidated subsidiaries (including trust-preferred securities), less goodwill and certain other intangible assets. Not more than 25% of qualifying Tier I capital may consist of trust-preferred securities. Tier II capital consists of hybrid capital instruments, perpetual debt, mandatory convertible debt securities, a limited amount of subordinated debt, preferred stock that does not qualify as Tier I capital, a limited amount of the allowance for loan and lease losses and a limited amount of unrealized holding gains on equity securities. Tier III capital consists of qualifying unsecured subordinated debt. The sum of Tier II and Tier III capital may not exceed the amount of Tier I capital.

The guidelines require a minimum ratio of qualifying total capital to risk-adjusted assets of 8% and a minimum ratio of Tier 1 capital to risk-adjusted assets of 4%. In addition to the risk-based guidelines, federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to adjusted average assets, referred to as the leverage ratio. For a banking organization rated in the highest of the six categories used by regulators to rate banking organizations (CAMELS), the minimum leverage ratio of Tier 1 capital to total assets must be 3%. All other institutions are required to maintain a minimum leverage ratio of 4%. In addition to these uniform risk-based capital guidelines and leverage ratios that apply across the industry, the regulators have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above the minimum guidelines and ratios.

In addition, federal banking regulators may set capital requirements higher than the minimums described above for financial institutions whose circumstances warrant it. For example, a financial institution experiencing or anticipating significant growth may be expected to maintain capital positions substantially above the minimum supervisory levels

without significant reliance on intangible assets.

TABLE OF CONTENTS

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

	December 31, 2011				December 31, 2010			
(Dollar amounts in thousands)	Consolidated		Bank		Consolidated		Bank	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital to risk-weighted assets:								
Actual	$50,512	17.85%	$45,550	16.25%	$37,912	13.34%	$40,850	14.52%
For capital adequacy purposes	22,636	8.00 %	22,422	8.00 %	22,738	8.00 %	22,504	8.00 %
To be well capitalized	N/A	N/A	28,027	10.00%	N/A	N/A	28,130	10.00%
Tier 1 capital to risk-weighted assets:								
Actual	$47,008	16.61%	$42,046	15.00%	$34,388	12.10%	$37,326	13.27%
For capital adequacy purposes	11,318	4.00 %	11,211	4.00 %	11,369	4.00 %	11,252	4.00 %
To be well capitalized	N/A	N/A	16,816	6.00 %	N/A	N/A	16,878	6.00 %
Tier 1 capital to average assets:								
Actual	$47,008	9.71 %	$42,046	8.69 %	$34,388	7.23 %	$37,326	7.92 %
For capital adequacy purposes	19,362	4.00 %	19,347	4.00 %	19,034	4.00 %	18,858	4.00 %
To be well capitalized	N/A	N/A	24,183	5.00 %	N/A	N/A	23,572	5.00 %

Prompt Corrective Action and Other Enforcement Mechanisms. Federal banking agencies possess broad powers to take corrective and other supervisory action to resolve the problems of insured depository institutions, including but not limited to those institutions that fall below one or more prescribed minimum capital ratios. Each federal banking agency has promulgated regulations defining the following five categories in which an insured depository institution will be placed, based on its capital ratios: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. At December 31, 2011, the Bank exceeded the required ratios for classification as well capitalized.

An institution that, based upon its capital levels, is classified as well capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions. The federal banking agencies, however, may not treat a significantly undercapitalized institution as critically undercapitalized.

In addition to measures taken under the prompt corrective action provisions, commercial banking organizations may be subject to potential enforcement actions by the federal regulators for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation, or any condition imposed in writing by the agency or any written agreement with the agency. Finally, pursuant to an interagency agreement, the FDIC can examine any institution that has a substandard regulatory examination score or is considered undercapitalized without the express permission of the institution s primary regulator.

Safety and Soundness Standards. The federal banking agencies have adopted guidelines designed to assist the federal banking agencies in identifying and addressing potential safety and soundness concerns before capital becomes impaired. The guidelines set forth operational and managerial standards relating to: (i) internal controls, information systems and internal audit systems, (ii) loan documentation, (iii) credit underwriting, (iv) asset growth, (v) earnings, and (vi) compensation, fees and benefits. In addition, the federal banking agencies have also adopted safety and

soundness guidelines with respect to asset quality and earnings standards. These guidelines provide six standards for establishing and maintaining a system to identify problem assets and prevent those assets from deteriorating. Under these standards, an insured depository institution should: (i) conduct periodic asset quality reviews to identify problem assets, (ii) estimate the inherent losses in problem assets and establish reserves that are sufficient to absorb estimated losses, (iii) compare problem asset totals to capital, (iv) take appropriate corrective action to resolve problem assets, (v) consider the size and potential risks of material asset concentrations, and (vi) provide periodic asset quality

TABLE OF CONTENTS

reports with adequate information for management and the board of directors to assess the level of asset risk. These guidelines also set forth standards for evaluating and monitoring earnings and for ensuring that earnings are sufficient for the maintenance of adequate capital and reserves.

Insurance of Accounts. The Bank s deposits are insured up to applicable limits by the DIF of the FDIC and are subject to deposit insurance assessments to maintain the DIF. The FDIC utilizes a risk-based assessment system that imposes insurance premiums based upon a risk matrix that takes into account a bank s capital level and supervisory rating. Risk Category I is the lowest risk category while Risk Category IV is the highest risk category.

In 2010, the Dodd-Frank Act revised the statutory authorities governing the FDIC s management of the DIF. Among other things, the Dodd-Frank Act (1) raised the minimum fund reserve ratio from 1.15% to 1.35%, (2) requires the fund reserve ratio to reach 1.35% by September 30, 2020, (3) eliminated the requirement that the FDIC provides dividends from the DIF when the reserve ratio is between 1.35% and 1.50%, (4) removed the 1.50% cap on the reserve ratio, (5) granted the FDIC the sole discretion in determining whether to suspend or limit the declaration or payment of dividends and (6) changed the assessment base for banks from insured deposits to the average total assets of the bank minus the average tangible equity of the bank during the assessment period. In December 2010, the FDIC set the minimum reserve ratio at 2.00%. In addition, the FDIC adopted a Restoration Plan that, among other things, (1) eliminated the uniform 3 basis point increase in initial assessment rates that were scheduled to take effect on January 1, 2011, (2) pursued further rulemaking in 2011 regarding the method used to offset the effect on banks with less than $10 billion in assets of the requirement that the reserve ratio reach 1.35% and (3) at least semiannually, will update its projections for the DIF and increase or decrease assessment rates if needed. On February 7, 2011 the FDIC adopted final rules to implement the dividend provisions of the Dodd-Frank Act, changed the assessment base and set new assessment rates. In addition, as part of its final rules, the FDIC made certain assessment rate adjustments by (1) altering the unsecured debt adjustment by adding an adjustment for long-term debt issued by another insured depository institution and (2) eliminating the secured liability adjustment, which changed the brokered deposit adjustment to conform to the change in the assessment base. The new assessment rates became effective April 1, 2011. The new initial base assessment rates range from 2.5 to 9 basis points for Category I banks to 35 basis points for Category IV banks.

The FDIC may further increase or decrease the assessment rate schedule in order to manage the DIF to prescribed statutory target levels. An increase in the Risk Category for the Bank or in the assessment rates could have an adverse effect on the Bank s earnings. The FDIC may terminate deposit insurance if it determines the institution involved has engaged in or is engaging in unsafe or unsound banking practices, is in an unsafe or unsound condition, or has violated applicable laws, regulations or orders.

In addition, all institutions with deposits insured by the FDIC are required to pay assessments to fund interest payments on bonds issued by the Financing Corporation (FICO), a mixed-ownership government corporation established to recapitalize a predecessor to the DIF. The current annualized assessment rate is 0.660 basis points or approximately 0.165 basis points per quarter. These assessments will continue until the Financing Corporation bonds mature in 2019.

The enactment of the Emergency Economic Stabilization Act of 2008 temporarily raised the limit on federal deposit insurance coverage from $100,000 to $250,000 per depositor. The temporary increase in deposit insurance coverage became effective on October 3, 2008. On May 20, 2009, the FDIC extended this increased insurance level to $250,000 per depositor through December 31, 2013. On July 21, 2010, the Dodd-Frank Act permanently increased the FDIC insurance coverage to $250,000 per depositor.

On October 14, 2008, the FDIC announced its temporary Transaction Account Guarantee Program (TAGP), which provided full coverage for noninterest-bearing transaction deposit accounts at FDIC-insured institutions that agreed to participate in the program. The unlimited coverage applied to all personal and business checking deposit accounts that do not earn interest, which include demand deposit accounts, low-interest NOW accounts (NOW accounts that cannot earn more than 0.25% interest), Official Items and IOLTA accounts. A 10 basis point surcharge was added to a participating institution s current insurance assessment in order to fully cover all transaction accounts. This unlimited insurance coverage was temporary and was originally scheduled to expire on December 31, 2009. On August 26, 2009, the FDIC extended the program

TABLE OF CONTENTS

through June 30, 2010 and it was again extended through December 31, 2010. The deposit insurance surcharge was increased from 10 to 25 basis points for institutions electing to continue in the TAGP. On July 21, 2010, the Dodd-Frank Act extended unlimited FDIC insurance to noninterest-bearing transaction deposit accounts. It does not apply to accounts earning any level of interest with the exception of IOLTA accounts. As this unlimited FDIC insurance coverage is applicable to all applicable deposits at any FDIC-insured financial institution, there is no additional FDIC insurance surcharge related to this coverage after December 31, 2010.

On May 22, 2009, the FDIC adopted a final rule imposing a 5 basis point special assessment on each insured depository institution s assets minus Tier 1 capital as of June 30, 2009. This special assessment was collected on September 30, 2009. Based on the Bank s assets and Tier 1 capital at that time, the assessment totaled $178,000.

On November 12, 2009, the FDIC adopted a final rule requiring insured institutions to prepay approximately three years of estimated insurance assessments. The prepayment allowed the FDIC to strengthen the cash position of the DIF immediately without impacting earnings of the industry. Payment of the prepaid assessment, which totaled $2.1 million, along with the payment of the regular third quarter assessment was due on December 30, 2009.

Interstate Banking and Branching. Banks have the ability, subject to certain State restrictions, to acquire, by acquisition or merger, branches outside its home state. The establishment of new interstate branches is also possible in those states with laws that expressly permit it. Interstate branches are subject to certain laws of the states in which they are located. Competition may increase further as banks branch across state lines and enter new markets.

Consumer Protection Laws and Regulations. The bank regulatory agencies are focusing greater attention on compliance with consumer protection laws and their implementing regulations. Examination and enforcement have become more intense in nature, and insured institutions have been advised to monitor carefully compliance with such laws and regulations. The Bank is subject to many federal consumer protection statutes and regulations, some of which are discussed below.

The Community Reinvestment Act (CRA) is intended to encourage insured depository institutions, while operating safely and soundly, to help meet the credit needs of their communities. The CRA specifically directs the federal regulatory agencies, in examining insured depository institutions, to assess a bank s record of helping meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices. The CRA further requires the agencies to take a financial institution s record of meeting its community credit needs into account when evaluating applications for, among other things, domestic branches, mergers or acquisitions, or holding company formations. The agencies use the CRA assessment factors in order to provide a rating to the financial institution. The ratings range from a high of outstanding to a low of substantial noncompliance. In its last examination for CRA compliance, as of April 21, 2008, the Bank was rated satisfactory.

On September 1, 2005, the federal banking agencies amended the CRA regulations to:

Establish the definition of Intermediate Small Bank as an institution with total assets of $250 million to $1 billion, without regard to any holding company; and

Take into account abusive lending practices by a bank or its affiliates in determining a bank s CRA rating.

The Fair Credit Reporting Act (FCRA), as amended by the Fair and Accurate Credit Transactions Act of 2003 (FACTA), requires financial firms to help deter identity theft, including developing appropriate fraud response programs, and give consumers more control of their credit data. It also reauthorizes a federal ban on state laws that interfere with corporate credit granting and marketing practices. In connection with the FACTA, financial institution regulatory agencies proposed rules that would prohibit an institution from using certain information about a consumer it received from an affiliate to make a solicitation to the consumer, unless the consumer has been notified and given a

chance to opt out of such solicitations. A consumer s election to opt out would be applicable for at least five years.

TABLE OF CONTENTS

The Federal Trade Commission (FTC), the federal bank regulatory agencies and the National Credit Union Administration (NCUA) have issued regulations (the Red Flag Rules) requiring financial institutions and creditors to develop and implement written identity theft prevention programs as part of the FACTA. The programs were required be in place by May 1, 2009 and must provide for the identification, detection and response to patterns, practices or specific activities known as red flags that could indicate identity theft. These red flags may include unusual account activity, fraud alerts on a consumer report or attempted use of suspicious account application documents. The program must also describe appropriate responses that would prevent and mitigate the crime and detail a plan to update the program. The program must be managed by the Board of Directors or senior employees of the institution or creditor, include appropriate staff training and provide oversight of any service providers.

The Check Clearing for the 21st Century Act (Check 21) facilitates check truncation and electronic check exchange by authorizing a new negotiable instrument called a substitute check, which is the legal equivalent of an original check. Check 21, effective October 28, 2004, does not require banks to create substitute checks or accept checks electronically; however, it does require banks to accept a legally equivalent substitute check in place of an original.

The Equal Credit Opportunity Act (ECOA) generally prohibits discrimination in any credit transaction, whether for consumer or business purposes, on the basis of race, color, religion, national origin, sex, marital status, age (except in limited circumstances), receipt of income from public assistance programs, or good faith exercise of any rights under the Consumer Credit Protection Act.

The Truth in Lending Act (TILA) is designed to ensure that credit terms are disclosed in a meaningful way so that consumers may compare credit terms more readily and knowledgeably. As a result of the TILA, all creditors must use the same credit terminology to express rates and payments, including the annual percentage rate, the finance charge, the amount financed, the total of payments and the payment schedule, among other things.

The Fair Housing Act (FHA) regulates many practices, including making it unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, color, religion, national origin, sex, handicap or familial status. A number of lending practices have been found by the courts to be, or may be considered, illegal under the FHA, including some that are not specifically mentioned in the FHA itself.

The Home Mortgage Disclosure Act (HMDA) grew out of public concern over credit shortages in certain urban neighborhoods and provides public information that will help show whether financial institutions are serving the housing credit needs of the neighborhoods and communities in which they are located. The HMDA also includes a fair lending aspect that requires the collection and disclosure of data about applicant and borrower characteristics as a way of identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes.

The term predatory lending, much like the terms safety and soundness and unfair and deceptive practices, is far-reaching and covers a potentially broad range of behavior. As such, it does not lend itself to a concise or a comprehensive definition. But typically predatory lending involves at least one, and perhaps all three, of the following elements:

Making unaffordable loans based on the assets of the borrower rather than on the borrower s ability to repay an obligation (asset-based lending)
Inducing a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced (loan flipping)
Engaging in fraud or deception to conceal the true nature of the loan obligation from an unsuspecting or unsophisticated borrower.

FRB regulations aimed at curbing such lending significantly widen the pool of high-cost home-secured loans covered by the Home Ownership and Equity Protection Act of 1994, a federal law that requires extra disclosures and consumer protections to borrowers. Lenders that violate the rules face cancellation of loans and penalties equal to the finance charges paid.

TABLE OF CONTENTS

Effective April 8, 2005, OCC guidelines require national banks and their operating subsidiaries to comply with certain standards when making or purchasing loans to avoid predatory or abusive residential mortgage lending practices. Failure to comply with the guidelines could be deemed an unsafe and unsound or unfair or deceptive practice, subjecting the bank to supervisory enforcement actions.

Finally, the Real Estate Settlement Procedures Act (RESPA) requires lenders to provide borrowers with disclosures regarding the nature and cost of real estate settlements. Also, RESPA prohibits certain abusive practices, such as kickbacks, and places limitations on the amount of escrow accounts. Penalties under the above laws may include fines, reimbursements and other penalties. Due to heightened regulatory concern related to compliance with the CRA, FACTA, TILA, FHA, ECOA, HMDA and RESPA generally, the Bank may incur additional compliance costs or be required to expend additional funds for investments in its local community.

Federal Home Loan Bank System. The Bank is a member of the FHLB. Among other benefits, each FHLB serves as a reserve or central bank for its members within its assigned region. Each FHLB is financed primarily from the sale of consolidated obligations of the FHLB system. Each FHLB makes available loans or advances to its members in compliance with the policies and procedures established by the Board of Directors of the individual FHLB. As an FHLB member, the Bank is required to own a certain amount of capital stock in the FHLB. At December 31, 2011, the Bank was in compliance with the stock requirements.

Federal Reserve System. The FRB requires all depository institutions to maintain noninterest bearing reserves at specified levels against their transaction accounts (primarily checking) and non-personal time deposits. At December 31, 2011, the Bank was in compliance with these requirements.

Item 1A. Risk Factors

Not required as the Corporation is a smaller reporting company.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Corporation owns no real property but utilizes the main office of the Bank, which is owned by the Bank. The Corporation s and the Bank s executive offices are located at 612 Main Street, Emlenton, Pennsylvania. The Corporation pays no rent or other form of consideration for the use of this facility.

The Bank owns and leases numerous other premises for use in conducting business activities. The Bank considers these facilities owned or occupied under lease to be adequate. For additional information regarding the Bank s properties, see Note 7 Premises and Equipment on page F-22 to the consolidated financial statements.

Item 3. Legal Proceedings

Neither the Bank nor the Corporation is involved in any material legal proceedings. The Bank, from time to time, is party to litigation that arises in the ordinary course of business, such as claims to enforce liens, claims involving the origination and servicing of loans, and other issues related to the business of the Bank. In the opinion of management,

the resolution of any such issues would not have a material adverse impact on the financial position, results of operation, or liquidity of the Bank or the Corporation.

Item 4. Mine Safety Disclosures

Not applicable.

TABLE OF CONTENTS

PART II

Item 5. Market for the Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market, Holder and Dividend Information

Emclaire Financial Corp. common stock is traded on NASDAQ Capital Market (NASDAQ) under the symbol EMCF . The listed market makers for the Corporation s common stock include:

Boenning and Scattergood, Inc.
4 Tower Bridge, Suite 300
200 Bar Harbor Drive
West Conshohocken, PA 19428
Telephone: (800) 889-6440

Janney Montgomery Scott LLC
1801 Market Street
Philadelphia, PA 19103-1675
Telephone: (215) 665-6000

Monroe Securities, Inc.
100 North Riverside Plaza
Suite 1620
Chicago, IL 60606
Telephone: (312) 327-2530

The Corporation has traditionally paid regular quarterly cash dividends. Future dividends will be determined by the Board of Directors after giving consideration to the Corporation s financial condition, results of operations, tax status, industry standards, economic conditions, regulatory requirements and other factors.

The following table sets forth the high and low sale and quarter-end closing market prices of our common stock for the last two years as reported by the Nasdaq Capital Market as well as cash dividends paid for the quarterly periods presented.

	Market Price			Cash
	High	Low	Close	Dividend
2011:				
Fourth quarter	$ 16.35	$ 14.80	$ 15.95	$ 0.16
Third quarter	18.05	15.00	16.35	0.16
Second quarter	18.50	15.69	16.62	0.16
First quarter	18.99	16.37	17.25	0.16
2010:				
Fourth quarter	$ 17.30	$ 15.81	$ 16.35	$ 0.14
Third quarter	18.00	15.55	16.50	0.14
Second quarter	16.50	14.36	15.85	0.14
First quarter	15.20	13.19	14.51	0.14

As of March 1, 2012, there were approximately 713 stockholders of record and 1,751,908 shares of common stock entitled to vote, receive dividends and considered outstanding for financial reporting purposes. The number of stockholders of record does not include the number of persons or entities who hold their stock in nominee or street name.

Common stockholders may have Corporation dividends reinvested to purchase additional shares. Participants may also make optional cash purchases of common stock through this plan and pay no brokerage commissions or fees. To obtain a plan document and authorization card call 800-757-5755.

Purchases of Equity Securities

The Corporation did not repurchase any of its equity securities in the year ended December 31, 2011.

Item 6. Selected Financial Data

Not required as the Corporation is a smaller reporting company.

TABLE OF CONTENTS

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis represents a review of the Corporation s consolidated financial condition and results of operations for the years ended December 31, 2011 and 2010. This review should be read in conjunction with the consolidated financial statements beginning on page F-1.

Overview

The Corporation reported an increase in net income available to common stockholders of $640,000 for 2011 as consolidated net income available to common stockholders amounted to $3.3 million or $1.98 per common share for 2011, compared to $2.7 million or $1.85 per common share for 2010. Net income available to common stockholders was impacted by the following:

Net interest income increased $624,000 or 4.2% in 2011. This increase was primarily related to a decrease in interest expense of $1.2 million or 16.9% as the Corporation s cost of funds decreased 29 basis points to 1.33% for 2011 from 1.62% for 2010.

Noninterest income decreased $365,000 or 8.7% to $3.8 million for the year ended December 31, 2011 from $4.2 million for the same period in 2010. The decrease was primarily related to a $493,000 decrease in nonrecurring securities gains and an $180,000 decrease in fees from financial services, which were partially offset by increases in customer service fees and other income of $71,000 and $248,000, respectively.

Provision for loan losses decreased $886,000 or 67.8% to $420,000 for the year ended December 31, 2011 from $1.3 million in 2010. The decrease was primarily related to the successful resolution and payoff of certain nonperforming loans during 2011, which led to an overall decrease in the provision for loan losses.

Noninterest expense increased $232,000 or 1.7% primarily due to increases in compensation and benefits, premises and equipment, professional fees and other noninterest expense of $248,000, $55,000, $158,000 and $54,000, respectively. Included in other noninterest expense was $334,000 in prepayment penalties incurred in the third quarter of 2011 associated with the early retirement of a $5.0 million Federal Home Loan Bank advance, compared to $557,000 in prepayment penalties related to the early retirement of $10.0 million in advances during 2010.

Changes in Financial Condition

Total assets increased $10.0 million or 2.1% to $491.9 million at December 31, 2011 from $481.9 million at December 31, 2010. This increase primarily related to increases in cash and equivalents and net loans receivable of $9.2 million and $6.4 million, respectively. Partially offsetting these increases, investment securities and other assets decreased $2.7 million and $1.9 million, respectively.

The Corporation s asset growth was primarily driven by increases in customer deposits of $6.8 million and stockholders equity of $11.6 million. Partially offsetting these increases, borrowed funds decreased $10.0 million.

Cash and cash equivalents. These accounts increased $9.2 million or 48.2% to $28.2 million at December 31, 2011 from $19.0 million at December 31, 2010. This increase primarily related to proceeds from investment security calls received in late December 2011, which were not redeployed into securities or loans before year-end. 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 decreased $2.7 million or 2.1% to $123.2 million at December 31, 2011 from $125.8 million at December 31, 2010. This decrease was partly related to the utilization of cash received from investment security calls to fund loan originations rather than security purchases. Partially offsetting this deployment strategy, net unrealized gains associated with the investment portfolio increased $4.2 million to $4.5 million at December 31, 2011 from $260,000 at December 31, 2010 primarily due to the decline in market interest rates during 2011.

TABLE OF CONTENTS

Loans receivable. Net loans receivable increased $6.4 million or 2.1% to $312.5 million at December 31, 2011 from $306.2 million at December 31, 2010 as residential first mortgages increased $9.0 million or 10.7%, commercial real estate loans increased $1.7 million or 1.9% and commercial business loans increased $46,000, partially offset by a $4.2 million or 5.6% decrease in home equity loans and lines of credit and an $801,000 decrease in consumer loans.

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 $5.9 million or 1.19% of total assets at December 31, 2011 compared to $7.0 million or 1.45% of total assets at December 31, 2010. Non-performing assets consisted of non-performing loans and real estate owned of $5.6 million and $307,000, respectively, at December 31, 2011 and $6.6 million and $373,000, respectively, at December 31, 2010. At December 31, 2011, non-performing loans consisted primarily of consumer, commercial mortgage and residential mortgage loans.

Federal bank stocks. Federal bank stocks were comprised of FHLB stock and FRB stock of $2.7 million and $984,000, respectively, at December 31, 2011. 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. The FHLB notified member banks in December 2008 that it was suspending dividend payments and the repurchase of capital stock; however, due to its improved financial condition, since the fourth quarter of 2010, the FHLB has repurchased a portion of the Bank s excess capital stock each quarter. The repurchases totaled $611,000 and $173,000, respectively, for the years ended December 31, 2011 and 2010.

Bank-owned life insurance (BOLI). The Corporation maintains single premium life insurance policies on 20 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 2011 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 decreased $215,000 or 2.3% to $9.0 million at December 31, 2011 from $9.2 million at December 31, 2010. The overall decrease in premises and equipment during the year was due to normal depreciation and amortization of $798,000, partially offset by capital expenditures of $583,000.

Goodwill. Goodwill was $3.7 million at December 31, 2011 and 2010. Goodwill is evaluated for possible impairment at least annually and more frequently if events and circumstances indicate that the asset might be impaired. Management evaluated goodwill and concluded that no impairment existed at December 31, 2011.

Core deposit intangible. The core deposit intangible was $1.6 million at December 31, 2011. In connection with the assumption of deposits through the 2009 Titusville branch purchase, the Bank recorded a core deposit intangible of $2.8 million. This asset represents 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 amortizes utilizing the 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 Corporation recorded $441,000 and $564,000 of intangible amortization in 2011 and 2010, respectively.

Deposits. Total deposits increased $6.8 million or 1.7% to $416.5 million at December 31, 2011 from $409.7 million at December 31, 2010. Noninterest bearing deposits increased $8.9 million or 11.8% during the year while interest bearing deposits decreased $2.1 million.

TABLE OF CONTENTS

Borrowed funds. Borrowed funds decreased $10.0 million or 33.3% to $20.0 million at December 31, 2011 from $30.0 million at December 31, 2010 due to the aforementioned $5.0 million prepayment of a long term FHLB advance and a $5.0 million paydown related to a line of credit with a correspondent bank.

Stockholders equity. Stockholders equity increased $11.6 million or 29.7% to $50.7 million at December 31, 2011 from $39.1 million at December 31, 2010 resulting primarily from the issuance of 290,004 shares or $4.6 million of common stock associated with a private placement to accredited investors. Also contributing to the increase, the Corporation received a $10.0 million investment from the U.S. Treasury Department under the Small Business Lending Fund (SBLF), a portion of which was used to fully redeem the $7.5 million of preferred stock issued to the U.S. Treasury in association with its participation in the Capital Repurchase Program (CPP) of the Troubled Asset Relief Program (TARP). Retained earnings increased $2.2 million related to net income less preferred and common stock dividends and accumulated other comprehensive income increased $2.2 million resulting from a change in the net unrealized losses on securities available for sale and to a lesser extent the funded status of the Corporation s defined benefit plan.

Changes in Results of Operations

The Corporation reported net income before accumulated preferred stock dividends and discount accretion of $3.8 million and $3.1 million in 2011 and 2010, 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.

TABLE OF CONTENTS

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,							
	2011				2010			
(Dollar amounts in thousands)	Average Balance	Interest	Yield/ Rate		Average Balance	Interest	Yield/ Rate	
Interest-earning assets:								
Loans, taxable	$296,551	$16,935	5.71	%	$291,358	$17,570	6.03	%
Loans, tax-exempt	12,521	650	5.19	%	6,661	396	5.95	%
Total loans receivable	309,072	17,585	5.69	%	298,019	17,966	6.03	%
Securities, taxable	91,306	2,370	2.59	%	96,286	2,528	2.63	%
Securities, tax-exempt	36,213	1,848	5.10	%	29,626	1,662	5.61	%
Total securities	127,519	4,218	3.31	%	125,912	4,190	3.33	%
Interest-earning deposits with banks	24,679	173	0.70	%	26,636	277	1.04	%
Federal bank stocks	3,873	55	1.42	%	4,212	46	1.09	%
Total interest-earning cash equivalents	28,552	228	0.80	%	30,848	323	1.05	%
Total interest-earning assets	**465,143**	**22,031**	**4.73%**		**454,779**	**22,479**	**4.94%**	
Cash and due from banks	2,534				2,406			
Other noninterest-earning assets	21,628				22,669			
Total Assets	$489,305				$479,854			
Interest-bearing liabilities:								
Interest-bearing demand deposits	$182,038	492	0.27	%	$171,932	826	0.48	%
Time deposits	149,794	4,196	2.80	%	154,726	4,580	2.96	%
Total interest-bearing deposits	331,832	4,688	1.41	%	326,658	5,406	1.65	%
Borrowed funds, short-term	3,414	159	4.66	%	5,022	241	4.80	%
Borrowed funds, long-term	22,068	1,025	4.64	%	31,466	1,422	4.52	%
Total borrowed funds	25,482	1,184	4.65	%	36,488	1,663	4.56	%
Total interest-bearing liabilities	**357,314**	**5,872**	**1.64%**		**363,146**	**7,069**	**1.95%**	
Noninterest-bearing demand deposits	82,697				74,082			
Funding and cost of funds	**440,011**	**5,872**	**1.33%**		**437,228**	**7,069**	**1.62%**	
Other noninterest-bearing liabilities	3,879				3,550			
Total Liabilities	443,890				440,778			
Stockholders Equity	45,415				39,076			
Total Liabilities and Stockholders Equity	$489,305				$479,854			
Net interest income		**$16,159**				**$15,410**		
Interest rate spread (difference between weighted average rate on			**3.09%**				**2.99%**	

interest-earning assets and interest-bearing liabilities)		
Net interest margin (net interest income as a percentage of average interest-earning assets)	**3.47%**	**3.39%**

TABLE OF CONTENTS

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.

	2011 versus 2010 Increase (decrease) due to		
(Dollar amounts in thousands)	Volume	Rate	Total
Interest income:			
Loans	$ 651	$ (1,032)	$ (381)
Securities	53	(25)	28
Interest-earning deposits with banks	(19)	(85)	(104)
Federal bank stocks	(4)	13	9
Total interest-earning assets	681	(1,129)	(448)
Interest expense:			
Deposits	84	(802)	(718)
Borrowed funds	(511)	32	(479)
Total interest-bearing liabilities	(427)	(770)	(1,197)
Net interest income	$ 1,108	$ (359)	$ 749

2011 Results Compared to 2010 Results

The Corporation reported net income before accumulated preferred stock dividends and discount accretion of $3.8 million and $3.1 million for 2011 and 2010, respectively. The $764,000 or 24.9% increase in net income was attributed to an increase in net interest income of $624,000 and a decrease in provision for loan losses of $886,000, partially offset by a decrease in noninterest income of $365,000 and increases in noninterest expense and provision for income taxes of $232,000 and $149,000, respectively.

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 $749,000 or 4.9% to $16.2 million for 2011, compared to $15.4 million for 2010. This increase in net interest income can be attributed to a decrease in interest expense of $1.2 million, partially offset by a decrease in tax equivalent interest income of $448,000.

Interest income. Tax equivalent interest income decreased $448,000 or 2.0% to $22.0 million for 2011, compared to $22.5 million for 2010. This decrease can be attributed to decreases in interest earned on loans and interest earning deposits of $381,000 and $104,000, respectively, partially offset by increases in interest earned on securities and federal bank stocks of $28,000 and $9,000, respectively.

Tax equivalent interest earned on loans receivable decreased $381,000 or 2.1% to $17.6 million for 2011, compared to $18.0 million for 2010. During that time, the yield on loans decreased 34 basis points to 5.69% for 2011, versus

6.03% for 2010 causing a $1.0 million decrease in interest income. Offsetting this unfavorable yield decline, average loans increased $11.1 million or 3.7%, generating $651,000 of additional loan interest income.

TABLE OF CONTENTS

Tax equivalent interest earned on securities increased $28,000 to $4.2 million for 2011 and 2010. During this time, average securities increased $1.6 million or 1.3% accounting for $53,000 in additional security interest income. The average yield on securities decreased 2 basis points to 3.31% for 2011, versus 3.33% for 2010 causing a $25,000 decrease in interest income.

Interest earned on interest-earning deposit accounts decreased $104,000 or 37.5% to $173,000 for 2011, compared to $277,000 for 2010. The average yield on these accounts decreased 34 basis points or 32.7% resulting in an $85,000 decrease in interest income. Average interest-earning deposits decreased $2.0 million or 7.3%. This decrease caused a $19,000 decrease in interest income.

Interest earned on federal bank stocks increased $9,000 or 19.6% to $55,000 for 2011, compared to $46,000 for 2010.

Interest expense. Interest expense decreased $1.2 million or 16.9% to $5.9 million for 2011, compared to $7.1 million for 2010. This decrease can be attributed to decreases in interest incurred on interest-bearing deposits and borrowed funds of $718,000 and $479,000, respectively.

Deposit interest expense decreased $718,000 or 13.3% to $4.7 million for 2011, compared to $5.4 million for 2010. The rate on interest-bearing deposits decreased by 24 basis points or 14.5% to 1.41% for 2011 versus 1.65% for 2010 accounting for an $802,000 decrease in interest expense. Average interest-bearing deposits increased $5.2 million or 1.6% accounting for $84,000 in additional interest expense.

Interest expense on borrowed funds decreased $479,000 or 28.8% to $1.2 million for 2011 compared to $1.7 million for 2010. Average borrowed funds decreased $11.0 million or 30.2% accounting for a decrease in interest expense of $511,000. The average rate on borrowed funds increased 9 basis points to 4.65% for 2011 versus 4.56% for 2010. This increase in rate accounted for $32,000 of additional interest expense.

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 probable incurred losses 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.

Nonperforming loans decreased $1.0 million or 15.8% to $5.6 million at December 31, 2011 from $6.6 million at December 31, 2010. This decrease was primarily due to an $800,000 principal payment made on one problem loan during the third quarter of 2011. While 2011 charge-offs increased to $1.1 million in 2011 compared to $552,000 in 2010, a significant portion of the charge-offs experienced during 2011 related to four loans with prior specific reserves allocated. While these charge-offs resulted in an increase in the Corporation s historical loss experience, the decrease in specific reserves was greater than the result of increasing general reserves triggered by these charge-offs. Specific reserves totaling $568,000 had been allocated during the fourth quarter of 2010 associated with the previously mentioned problem loan resolved during 2011.

The provision for loan losses decreased $886,000 or 67.8% to $420,000 for 2011, compared to $1.3 million for 2010. The Corporation s allowance for loan losses amounted to $3.5 million or 1.12% of the Corporation s total loan portfolio at December 31, 2011, compared to $4.1 million or 1.33% of total loans at December 31, 2010. The allowance for loan losses as a percentage of non-performing loans at December 31, 2011 and 2010 was 63.5% and 62.5%, respectively.

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 decreased $365,000 or 8.7% to $3.8 million for 2011, compared to $4.2 million for 2010. This decrease was primarily due to a decrease in net gains on securities available for sale from $975,000 in 2010 to $482,000 in 2011. Included in the 2010 and 2011 gains, $565,000 and $355,000, respectively, were related to balance sheet management strategies whereby securities were sold to prepay long term FHLB advances and associated security gains were used to offset the

TABLE OF CONTENTS

prepayment penalties related to the early retirement of the advances. Also contributing to the decrease in noninterest income, commissions on financial services decreased $180,000 or 25.7% due partly to a decrease in the number of representatives in the division. Partially offsetting these decreases, interchange fee income and customer service fees increased $216,000 and $71,000, respectively, primarily related to deposit account growth.

Noninterest expense. Noninterest expense increased $232,000 or 1.7% to $14.0 million for 2011, compared to $13.8 million for 2010. This increase in noninterest expense was comprised of increases in compensation and employee benefits, premises and equipment, professional fees and other expenses, partially offset by decreases in FDIC insurance and intangible amortization.

The largest component of noninterest expense, compensation and employee benefits, increased $248,000 or 3.6% to $7.1 million for 2011, compared to $6.9 million for 2010. This increase was primarily related to normal compensation increases and higher incentive program payouts.

Premises and equipment expense increased $55,000 or 2.6% to $2.2 million for 2011, compared to $2.1 million for 2010, primarily related to increased equipment service contract expenses and increased costs associated with the fourth quarter 2010 purchase of the Titusville, Pennsylvania branch office building.

The Corporation recognized $441,000 of intangible amortization in 2011 compared to $564,000 in 2010 associated with a core deposit intangible asset of $2.8 million that was recorded related to the 2009 branch acquisition.

Professional fees increased $158,000 or 28.8% to $706,000 for 2011, compared to $548,000 for 2010. This increase was primarily related to increased legal and accounting fees due in part to increased loan workout costs and additional internal audits performed during 2011.

FDIC expense decreased $160,000 or 28.1% to $410,000 for 2011, compared to $570,000 for 2010. This was primarily the result of legislative changes that adjusted the assessment base, which reduced the assessment rate.

Other noninterest expense increased $54,000 or 1.7% to $3.2 million for 2011, compared to $3.1 million for 2010. Included in this category were $334,000 and $557,000 in 2011 and 2010, respectively, related to prepayment penalties assessed on the aforementioned early retirement of FHLB advances. Contributing to the increase in other noninterest expense, contributions, loan costs and collection costs increased $51,000, $42,000 and $38,000, respectively.

The provision for income taxes increased $149,000 to $950,000 for 2011, compared to $801,000 for 2010 due to higher pre-tax income.

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), Treasurer and Chief Financial Officer (CFO) and 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 of the Corporation.

TABLE OF CONTENTS

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 within internal policy limits of between a positive and negative 15% 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, at December 31, 2011, the Corporation s interest-earning assets maturing or repricing within one year totaled $167.0 million while the Corporation s interest-bearing liabilities maturing or repricing within one year totaled $137.2 million, providing an excess of interest-earning assets over interest-bearing liabilities of $29.8 million or 6.05% of total assets. At December 31, 2011, the percentage of the Corporation s assets to liabilities maturing or repricing within one year was 121.7%.

The following table presents the amounts of interest-earning assets and interest-bearing liabilities outstanding as of December 31, 2011 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	$107,311	$59,663	$143,707	$95,799	$62,097	$468,577
Total interest-bearing liabilities	86,867	50,350	102,640	59,645	52,095	351,597
Interest rate sensitivity gap	$20,444	$9,313	$41,067	$36,154	$10,002	$116,980

Cumulative rate sensitivity gap	$20,444		$29,757		$70,824		$106,978		$116,980	
Ratio of gap during the period to total interest earning assets	4.36	%	1.99	%	8.76	%	7.72	%	2.13	%
Ratio of cumulative gap to total interest earning assets	4.36	%	6.35	%	15.11	%	22.83	%	24.96	%

TABLE OF CONTENTS

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.

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 Board of Directors 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 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 provided by a federal regulatory agency and are applied consistently across the different rate risk measures.

While the Corporation currently utilizes certain assumptions provided by a federal regulatory agency for gap analysis, earnings simulation modeling and net portfolio equity valuation analysis, beginning in 2012, assumptions will be based on the Corporation s historical experience.

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

Net interest income simulation. Given a 200 basis point immediate increase or decrease in market interest rates, net interest income may not change by more than 15% 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 20% 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, 2011 and 2010, respectively. This analysis was done assuming that the interest-earning asset and interest-bearing liability levels at December 31, 2011 remained constant. The impact of the market rate movements on net interest income was developed by simulating the effects of rates changing immediately for a one-year period from the December 31, 2011 levels for net interest income.

	Increase	Decrease

		+100 BP	+200 BP	-100 BP	-200 BP
2011 Net interest income	increase (decrease)	2.72 %	4.15 %	(3.17%)	(7.63%)
2010 Net interest income	increase (decrease)	2.77 %	5.02 %	(4.69%)	(8.25%)

TABLE OF CONTENTS

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 (GAAP) 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 $11.6 million or 29.7% to $50.7 million at December 31, 2011 from $39.1 million at December 31, 2010. Net income of $3.8 million in 2011 represented an increase in earnings of $764,000 or 24.9% compared to 2010. Returns on average equity and assets were 8.44% and 0.78%, respectively, for 2011.

The Corporation enhanced its already strong capital position as its capital to assets ratio increased to 10.3% at December 31, 2011 from 8.1% at December 31, 2010. During the first quarter of 2011, the Corporation raised $4.6 million in capital, net of expenses through the issuance of 290,004 shares of common stock in a private placement to accredited investors. During the third quarter of 2011, the Corporation received a $10.0 million investment from the U.S. Treasury Department under the SBLF, a portion of which was used to fully redeem the $7.5 million of preferred stock issued to the U.S. Treasury under the CPP. In addition, stockholders have taken part in the Corporation s dividend reinvestment plan introduced during 2003 with 46% of registered shareholder accounts active in the plan at December 31, 2011.

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, 2011, 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 2011, the Corporation used its sources of funds primarily to fund loan commitments. As of December 31, 2011, the Corporation had outstanding loan commitments, including undisbursed loans and amounts available under credit lines, totaling $43.8 million, and standby letters of credit totaling $245,000. 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, 2011, time deposits amounted to $145.5 million or 34.9% of the Corporation s total consolidated deposits, including approximately $40.4 million 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.

TABLE OF CONTENTS

Aside from liquidity available from customer deposits or through sales and maturities of securities, the Corporation has alternative sources of funds. These sources include a $5.5 million line of credit with a correspondent bank of which $0 is outstanding, 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, 2011, the Corporation s borrowing capacity with the FHLB, net of funds borrowed, was $139.3 million.

The Corporation paid quarterly cash dividends over the past two years. The Corporation paid dividends of $0.16 and $0.14 per common share for the four quarters of 2011 and 2010, respectively. On February 15, 2012, the Corporation declared a quarterly dividend of $0.18 per common share payable on March 23, 2012 to shareholders of record on March 1, 2012. 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, which 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 GAAP 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.

TABLE OF CONTENTS

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) whether the market decline was affected by macroeconomic conditions and (4) whether the Corporation has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery.

Goodwill and intangible assets. Goodwill represents the excess cost over fair value of assets acquired in a business combination. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives to their estimated residual values. Goodwill is subject to ongoing periodic impairment tests based on the fair value of the reporting unit compared to its carrying amount, including goodwill. As of November 30, 2011, the required annual impairment test of goodwill was performed and no impairment existed as of the valuation date. If for any future period we determine that there has been impairment in the carrying value of our goodwill balances, we will record a charge to our earnings, which could have a material adverse effect on net income, but not risk based capital ratios.

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

Not applicable.

Item 9A. 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 CFO, 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, 2011, the Corporation carried out an evaluation, under the supervision and with the participation of the Corporation s management, including the Corporation s CEO and CFO, 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 CFO concluded that the Corporation s disclosure controls and procedures were effective.

During the fourth quarter of fiscal year 2011, 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.

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.

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.

TABLE OF CONTENTS

Management s Report on Internal Control Over Financial Reporting

Management completed an assessment of the Corporation s internal control over financial reporting as of December 31, 2011. 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, 2011.

Item 9B. Other Information

None.

TABLE OF CONTENTS

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 25, 2012 (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 CFO. 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 CFO 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.

Equity Compensation Plan Information. The following table provides certain information as of December 31, 2011 with respect to shares of common stock that may be issued under our equity compensation plans, which consists of the 2007 Stock Incentive Plan and Trust, which was approved by shareholders in April 2007.

Plan Category	Number of securities to be issued upon exercise of outstanding options	Weighted-average exercise price of outstanding options[1]	Number of securities remaining available for issuance under equity compensation plans (excluding securities reflected in the first

			column)
Equity compensation plans approved by security holders	94,000	$ 24.51	32,783
Equity compensation plans not approved by security holders	0		0
Total	94,000	$ 24.51	32,783

(1) Options outstanding have been granted pursuant to the 2007 Stock Incentive Plan and Trust (Plan). The Plan provides for the grant of options to purchase up to 126,783 shares of common stock of which options to purchase 94,000 shares were outstanding at December 31, 2011. The Plan also provides for grants of up to 50,713 shares of restricted common stock of which 27,000 shares have been granted.

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.

TABLE OF CONTENTS

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 10.1-10.7 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.

3.1	Articles of Incorporation of Emclaire Financial Corp.(1)
3.2	Bylaws of Emclaire Financial Corp.(1)
3.3	Statement with respect to shares for Series B Preferred Stock.(2)
4.0	Specimen Common Stock Certificate of Emclaire Financial Corp.(3)
4.1	Form of certificate for Series B Preferred Stock.(2)
10.1	Amended and Restated Employment Agreement between Emclaire Financial Corp., the Farmers National Bank of Emlenton and William C. Marsh, dated as of November 16, 2011.(4)*
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.(4)*
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.(5)*
10.4	Change in Control Agreement between Emclaire Financial Corp., the Farmers National Bank of Emlenton and certain executive officer, dated as of August 2, 2010.(6)*
10.5	Group Term Carve-Out Plan between the Farmers National Bank of Emlenton and 20 Officers and Employees.(7)*
10.6	Supplemental Executive Retirement Plan Agreement between the Farmers National Bank of Emlenton and Six Officers.(7)*
10.7	Farmers National Bank of Emlenton Deferred Compensation Plan.(8)*
10.8	Farmers National Bank of Emlenton 2007 Stock Incentive Plan and Trust.(9)*
10.9	Securities Purchase Agreement, dated August 18, 2011 between the Corporation and the U.S. Department of the Treasury with respect to the Series B Preferred Stock.(2)
11.0	Statement regarding computation of earnings per share (see Note 1 of the Notes to Consolidated Financial Statements in the Annual Report).
14.0	Code of Personal and Business Conduct and Ethics.(10)
20.0	Emclaire Financial Corp. Dividend Reinvestment and Stock Purchase Plan.(11)
21.0	Subsidiaries of the Registrant (see information contained herein under Item 1. Description of Business Subsidiary Activity).
31.1	Principal Executive Officer Section 302 Certification.
31.2	Principal Financial Officer Section 302 Certification.

32.1	Principal Executive Officer Section 906 Certification.
32.2	Principal Financial Officer Section 906 Certification.
99.1	Principal Executive Officer Section 111 Certification.
99.2	Principal Financial Officer Section 111 Certification.
101.INS	XBRL Instance Document**

TABLE OF CONTENTS

101.SCH	XBRL Taxonomy Extension Schema Document**
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document**
101.DEF	XBRL Taxonomy Extension Definitions Linkbase Document**
101.LAB	XBRL Taxonomy Extension Label Linkbase Document**
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document**

* Compensatory plan or arrangement.

** These interactive data files shall not be deemed filed for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under those sections.

(1) 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.

(2) Incorporated by reference to the Registrant s Current Report on Form 8-K dated August 18, 2011.

(3) Incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 1997.

(4) Incorporated by reference to the Registrant s Current Report on Form 8-K dated November 16, 2011.

(5) Incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2009.

(6) Incorporated by reference to the Registrant s Current Report on Form 10-Q for the quarter ended June 30, 2010.

(7) Incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2002.

(8) Incorporated by reference to the Registrant s Current Report on Form 8-K dated December 15, 2008.

(9) Incorporated by reference to the Registrant s Current Report on Form DEF 14A dated March 23, 2007.

(10) Incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2004.

(11) Incorporated by reference to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2001.

TABLE OF CONTENTS

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.
By:

/s/ William C. Marsh
William C. Marsh
Chairman, Chief Executive Officer,
President and Director
(Duly Authorized Representative)

Dated: March 23, 2012

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)

Date: March 23, 2012

By:

/s/ Matthew J. Lucco
Matthew J. Lucco
Treasurer and Chief Financial Officer
(Principal Financial Officer)

Date: March 23, 2012

By:

/s/ Amanda L. Engles
Amanda L. Engles
Secretary
(Principal Accounting Officer)
Date: March 23, 2012

By:

/s/ Ronald L. Ashbaugh
Ronald L. Ashbaugh
Director
Date: March 23, 2012

By:

/s/ David L. Cox
David L. Cox
Director
Date: March 23, 2012

By:

/s/ James M. Crooks
James M. Crooks
Director
Date: March 23, 2012

By:

/s/ George W. Freeman
George W. Freeman
Director
Date: March 23, 2012

By:

/s/ Mark A. Freemer
Mark A. Freemer
Director
Date: March 23, 2012
By:

/s/ Robert L. Hunter
Robert L. Hunter
Director
Date: March 23, 2012
By:

/s/ John B. Mason
John B. Mason
Director
Date: March 23, 2012

/s/ Brian C. McCarrier
Brian C. McCarrier
Director
Date: March 23, 2012

TABLE OF CONTENTS

Financial Statements

Table of Contents

Reports of Independent Registered Public Accounting Firm	F-2
Consolidated Balance Sheets	F-3
Consolidated Statements of Income	F-4
Consolidated Statements of Changes in Stockholders Equity	F-5
Consolidated Statements of Cash Flows	F-6
Notes to Consolidated Financial Statements	F-7

TABLE OF CONTENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of Emclaire Financial Corp. as of December 31, 2011 and 2010, and the related consolidated statements of income, stockholders equity and cash flows for the years then ended. These financial statements are the responsibility of the Corporation 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. 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 financial statements. An audit also includes 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. as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

/s/ Crowe Horwath LLP

Cleveland, Ohio
March 23, 2012

TABLE OF CONTENTS

Consolidated Balance Sheets
(Dollar amounts in thousands, except share and per share data)

	December 31,	
	2011	2010
Assets		
Cash and due from banks	$2,516	$2,507
Interest earning deposits with banks	25,677	16,520
Total cash and cash equivalents	28,193	19,027
Securities available for sale, at fair value	123,154	125,820
Loans receivable, net of allowance for loan losses of $3,536 and $4,132	312,545	306,152
Federal bank stocks, at cost	3,664	4,129
Bank-owned life insurance	5,809	5,596
Accrued interest receivable	1,630	1,763
Premises and equipment, net	9,026	9,241
Goodwill	3,664	3,664
Core deposit intangible, net	1,580	2,021
Prepaid expenses and other assets	2,617	4,472
Total Assets	**$491,882**	**$481,885**
Liabilities and Stockholders Equity		
Liabilities		
Deposits:		
Non-interest bearing	$84,871	$75,941
Interest bearing	331,597	333,717
Total deposits	416,468	409,658
Borrowed funds:		
Short-term		5,000
Long-term	20,000	25,000
Total borrowed funds	20,000	30,000
Accrued interest payable	541	649
Accrued expenses and other liabilities	4,143	2,460
Total Liabilities	441,152	442,767
Commitments and Contingent Liabilities		
Stockholders Equity		
Preferred stock, $1.00 par value, 3,000,000 shares authorized;		
Series A, cumulative preferred stock, $7,500 liquidation value, 0 and 7,500 shares issued and outstanding, respectively		7,447
Series B, non-cumulative preferred stock, $10,000 liquidation value, 10,000 and 0 shares issued and outstanding, respectively	10,000	
Warrants		88
Common stock, $1.25 par value, 12,000,000 shares authorized; 1,853,925 and 1,559,421 shares issued; 1,751,908 and 1,457,404 shares outstanding	2,317	1,949
Additional paid-in capital	19,155	14,812

Treasury stock, at cost; 102,017 shares	(2,114)	(2,114)
Retained earnings	19,948	17,705
Accumulated other comprehensive income (loss)	1,424	(769)
Total Stockholders Equity	50,730	39,118
Total Liabilities and Stockholders Equity	**$491,882**	**$481,885**

See accompanying notes to consolidated financial statements.

TABLE OF CONTENTS

Consolidated Statements of Income
(Dollar amounts in thousands, except share and per share data)

	Year ended December 31,	
	2011	2010
Interest and dividend income		
Loans receivable, including fees	$ 17,389	$ 17,845
Securities:		
Taxable	2,370	2,528
Exempt from federal income tax	1,292	1,156
Federal bank stocks	55	46
Deposits with banks	173	277
Total interest and dividend income	21,279	21,852
Interest expense		
Deposits	4,688	5,406
Short-term borrowed funds	159	241
Long-term borrowed funds	1,025	1,422
Total interest expense	5,872	7,069
Net interest income	15,407	14,783
Provision for loan losses	420	1,306
Net interest income after provision for loan losses	14,987	13,477
Noninterest income		
Fees and service charges	1,490	1,419
Commissions on financial services	520	700
Title premiums	88	106
Other-than-temporary impairment losses on equity securities		(55)
Net gain on sales of available for sale securities	482	1,030
Earnings on bank-owned life insurance	246	239
Other	1,015	767
Total noninterest income	3,841	4,206
Noninterest expense		
Compensation and employee benefits	7,118	6,870
Premises and equipment	2,194	2,139
Intangible asset amortization	441	564
Professional fees	706	548
Federal deposit insurance	410	570
Other	3,176	3,122
Total noninterest expense	14,045	13,813
Income before provision for income taxes	4,783	3,870
Provision for income taxes	950	801
Net income	3,833	3,069
Preferred stock dividends and discount accretion	517	393
Net income available to common stockholders	**$ 3,316**	**$ 2,676**

Earnings per common share		
Basic	**$ 1.98**	**$ 1.85**
Diluted	**$ 1.98**	**$ 1.85**

See accompanying notes to consolidated financial statements.

TABLE OF CONTENTS

Consolidated Statements of Changes in Stockholders Equity
(Dollar amounts in thousands, except share and per share data)

	Preferred Stock	Warrants	Common Stock	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at January 1, 2010	**$7,430**	**$88**	**$1,949**	**$14,685**	**$(2,653)**	**$15,967**	**$(432)**	**$37,034**
Comprehensive income:								
Net income						3,069		3,069
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 ($1)							(3)	(3)
Change in net unrealized losses on securities available for sale, net of taxes of ($64)							(123)	(123)
Change in funded status of defined benefit plan, net of taxes of ($109)							(211)	(211)
Comprehensive income								2,732
Stock compensation expense				127				127
Reissuance of treasury stock (26,000 shares)					539	(129)		410
Preferred dividends and accretion of discount	17					(393)		(376)
Cash dividends declared on common stock ($0.56 per share)						(809)		(809)
Balance at December 31, 2010	**7,447**	**88**	**1,949**	**14,812**	**(2,114)**	**17,705**	**(769)**	**39,118**
Comprehensive income:								
Net income						3,833		3,833
Change in net unrealized gains on securities available							2,776	2,776

for sale, net of taxes of $1,430								
Change in funded status of defined benefit plan, net of taxes of ($300)							(583)	(583)
Comprehensive income								6,026
Stock compensation expense				98				98
Issuance of common stock (290,004 shares)			362	4,214				4,576
Issuance of common stock for restricted stock awards (4,500 shares)			6	(6)				
Redemption of preferred stock, Series A	(7,500)							(7,500)
Issuance of preferred stock, Series B	10,000							10,000
Warrant repurchase		(88)		37				(51)
Preferred dividends and accretion of discount	53					(517)		(464)
Cash dividends declared on common stock ($0.64 per share)						(1,073)		(1,073)
Balance at December 31, 2011	**$10,000**	**$**	**$2,317**	**$19,155**	**$(2,114)**	**$19,948**	**$1,424**	**$50,730**

See accompanying notes to consolidated financial statements.

TABLE OF CONTENTS

Consolidated Statements of Cash Flows
(Dollar amounts in thousands, except share and per share data)

	Year ended December 31,	
	2011	2010
Cash flows from operating activities		
Net income	$ 3,833	$ 3,069
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	798	914
Provision for loan losses	420	1,306
Amortization of premiums and (accretion of discounts), net	219	217
Amortization of intangible assets and mortgage servicing rights	457	583
Securities impairment loss recognized in earnings		55
Realized gains on sales of available for sale securities, net	(482)	(1,030)
Net losses on foreclosed real estate	9	28
Restricted stock and stock option compensation	98	127
Increase in bank-owned life insurance, net	(213)	(208)
(Increase) decrease in accrued interest receivable	133	(189)
Decrease in deferred taxes	112	167
(Increase) decrease in prepaid expenses and other assets	1,712	(67)
Decrease in accrued interest payable	(108)	(62)
Decrease in accrued expenses and other liabilities	(381)	(2,316)
Net cash provided by operating activities	6,607	2,594
Cash flows from investing activities		
Loan originations and principal collections, net	(7,627)	(15,594)
Available for sale securities:		
Sales	28,978	43,809
Maturities, repayments and calls	73,780	113,674
Purchases	(95,318)	(177,199)
Redemption (purchase) of federal bank stocks	465	(4)
Purchases of premises and equipment	(583)	(985)
Proceeds from the sale of foreclosed real estate	556	222
Write-down of foreclosed real estate	10	
Net cash provided by (used in) investing activities	261	(36,077)
Cash flows from financing activities		
Net increase in deposits	6,810	24,333
Repayments on Federal Home Loan Bank advances	(5,000)	(10,000)
Net change in short-term borrowings	(5,000)	
Proceeds from issuance of common stock	4,576	
Proceeds from issuance of preferred stock (Series B)	10,000	
Proceeds from reissuance of treasury stock		410
Redemption of preferred stock (Series A)	(7,500)	

Warrant repurchase	(51)	
Dividends paid	(1,537)	(1,185)
Net cash provided by financing activities	2,298	13,558
Net increase (decrease) in cash and cash equivalents	9,166	(19,925)
Cash and cash equivalents at beginning of period	19,027	38,952
Cash and cash equivalents at end of period	$ 28,193	$ 19,027
Supplemental information:		
Interest paid	$ 5,980	$ 7,131
Income taxes paid	340	915
Supplemental noncash disclosures:		
Transfers from loans to foreclosed real estate	509	450

See accompanying notes to consolidated financial statements.

TABLE OF CONTENTS

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 U.S. generally accepted accounting principles (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 generally mature within 90 days 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, 2011 and 2010. Both required and excess reserves earn interest.

Dividend Restrictions. Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the Corporation or by the Corporation to shareholders.

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, net of tax.

Interest income from securities 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.

Securities (continued). Management evaluates securities for other-than-temporary impairment (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) whether the market decline was affected by macroeconomic conditions and (4) whether the Corporation has the intent to sell the debt security or more likely than not will be required to sell the security before the recovery of its amortized cost basis. If the Corporation intends to sell an impaired security, or if it is more likely than not the Corporation will be required to sell the security before its anticipated recovery, 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

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies (continued)

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. For equity securities determined to be other-than-temporarily impaired, the entire amount of impairment is recognized through earnings.

Loans Held for Sale. Mortgage 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 and charged to earnings. Mortgage loans held for sale are generally sold with servicing rights retained. The carrying value of mortgage loans sold is reduced by the amount allocated to the servicing right. 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 payoff 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 in interest income as an adjustment of the related loan yield using the interest method.

The accrual of interest on all classes of 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. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. 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 incurred 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.

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 collectability 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, prevailing economic conditions and other factors. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

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. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings (TDR) and classified as impaired.

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies (continued)

Factors considered by management in determining impairment on all loan classes include demonstrated ability to repay, 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. TDR s are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan s effective rate at inception. If a TDR is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of collateral. For TDR s that subsequently default, the Corporation determines the amount of reserves in accordance with accounting policies for the allowance for loan losses.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are individually classified as impaired. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Corporation over the prior 12 quarters. Qualitative factors considered by management include national and local economic and business conditions, changes in the nature and volume of the loan portfolio, quality of loan review systems, and changes in trends, volume and severity of past due, nonaccrual and classified loans, and loss and recovery trends. An unallocated component is maintained to cover uncertainties that could affect management s estimate of probable incurred 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. The Corporation s portfolio segments are as follows:

Residential mortgages Residential mortgage loans are loans to consumers utilized for the purchase, refinance or construction of a residence. Changes in interest rates or market conditions may impact a borrower s ability to meet contractual principal and interest payments.

Home equity loans and lines of credit Home equity loans and lines of credit are credit facilities extended to homeowners who wish to utilize the equity in their property in order to borrow funds for almost any consumer purpose. Property values may fluctuate in value due to economic and other factors.

Commercial real estate Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans. These loans are viewed primarily as cash flow loans and the repayment of these loans is largely dependent on the successful operation of the property. Loan performance may be adversely affected by factors impacting the general economy or conditions specific to real estate market such as geographic location and property type.

Commercial business Commercial credit is extended to business customers for use in normal operations to finance working capital needs, equipment purchases or other projects. The majority of these borrowers are customers doing business within our geographic region. These loans are generally underwritten individually and secured with the assets of the company and the personal guarantee of the business owners. Commercial loans are made based primarily on the historical and projected cash flow of the borrower and the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not behave as forecasted and collateral securing loans may fluctuate in value due to economic or individual performance factors.

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies (continued)

Consumer Consumer loans are loans to an individual for non-business purposes such as automobile purchases or debt consolidation. These loans are originated based primarily on credit scores and debt-to-income ratios which may be adversely affected by economic or individual performance factors.

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 and classified as restricted stock. 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. These stocks are periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Bank-Owned Life Insurance (BOLI). The Bank purchased life insurance policies on certain key officers and employees. BOLI is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

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 forty 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 useful lives. 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. Any such impairment will be recognized in the period identified. The Corporation has selected November 30 as the date to perform the annual impairment test. Goodwill is the only intangible asset with an indefinite life on the Corporation s balance sheet.

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 market prices for comparable mortgage servicing contracts, when available or alternatively is 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.

Other Real Estate Acquired Through Foreclosure (OREO). Real estate properties acquired through foreclosure are initially recorded at fair value less cost to sell when acquired, thereby establishing a new cost basis for the asset. These

assets are subsequently accounted for at the lower of carrying amount or fair value less cost to sell. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. 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 $307,000 and $373,000 at December 31, 2011 and 2010, respectively.

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies (continued)

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. Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized. A tax position is recognized as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the more likely than not test, no tax benefit is recorded. The Corporation recognizes interest and/or penalties related to income tax matters in income tax expense.

Earnings Per Common Share (EPS). Basic EPS excludes dilution and is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted EPS includes the dilutive effect of additional potential common shares issuable under stock options and warrants.

Comprehensive Income. Comprehensive income includes net income and other comprehensive income. Other comprehensive income (loss) is comprised of unrealized holding gains and losses on securities available for sale and changes in the over funded status of pension and other postretirement benefit plans which are also recognized as separate components of 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. Compensation cost is recognized for stock options and restricted stock awards issued, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Corporation s common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period.

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.

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.

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

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies (continued)

Loss Contingencies. Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

Recently Adopted Accounting Standards. In April 2011, the Financial Accounting Standards Board (FASB) amended existing guidance for assisting a creditor in determining whether a restructuring is a troubled debt restructuring. The amendments clarify the guidance for a creditor s evaluation of whether it has granted a concession and whether a debtor is experiencing financial difficulties. With regard to determining whether a concession has been granted, the guidance clarifies that creditors are precluded from using the effective interest method to determine whether a concession has been granted. In the absence of using the effective interest method, a creditor must now focus on other considerations such as the value of the underlying collateral, evaluation of other collateral or guarantees, the debtor s ability to access other funds at market rates, interest rate increases and whether the restructuring results in a delay in payment that is insignificant. This guidance is effective for interim and annual reporting periods beginning after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. For purposes of measuring impairment on newly identified troubled debt restructurings, the amendments should be applied prospectively for the first interim or annual period beginning on or after June 15, 2011. The adoption of this guidance did not have a material impact on the Corporation s consolidated financial statements.

In June 2011, the FASB amended existing guidance and eliminated the option to present the components of other comprehensive income as part of the statement of changes in shareholder s equity. The amendment requires that comprehensive income be presented in either a single continuous statement or in two separate consecutive statements. The amendments in this guidance which were not deferred are effective as of the beginning of the fiscal reporting year, and interim periods within the year, that begins after December 15, 2011. The adoption of this amendment will change the presentation of the components of comprehensive income for the Corporation as part of the consolidated statement of shareholder s equity.

In September 2011, the FASB amended existing guidance to simplify how entities, both public and nonpublic, test goodwill for impairment. The guidance permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The more-likely-than-not threshold is defined as having a likelihood of more than 50%. The amendments in this guidance are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity s financial statements for the most recent annual or interim period have not yet been issued. The Corporation early adopted the guidance in the fourth quarter of 2011 and the adoption did not have a material impact on its consolidated financial statements.

2. Issuance of Common Stock

On March 31, 2011, the Corporation sold 290,004 shares of common stock, par value $1.25 per share, in a private offering to accredited individual and institutional investors at $15.95 per share. The Corporation realized $4.6 million

in proceeds from the offering net of $48,000 of direct costs relating to the offering.

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

3. Participation in the Small Business Lending Fund (SBLF) of the U.S. Treasury Department (U.S. Treasury) and Repurchase of Shares Issued Under the Troubled Asset Relief Program (TARP)

On August 18, 2011, the Corporation entered into a Securities Purchase Agreement (the Agreement) with the Secretary of the U.S. Treasury, pursuant to which the Corporation issued and sold to the U.S. Treasury 10,000 shares of Senior Non-Cumulative Perpetual Preferred Stock, Series B (Series B Preferred Stock), having a liquidation preference of $1,000 per share, for aggregate proceeds of $10.0 million. The issuance was pursuant to the U.S. Treasury s SBLF program, a $30.0 billion fund established under the Small Business Jobs Act of 2010, which encourages lending to small businesses by providing capital to qualified community banks with assets less than $10.0 billion. The Series B Preferred Stock is entitled to receive non-cumulative dividends payable quarterly on each January 1, April 1, July 1 and October 1, beginning October 1, 2011. The dividend rate, which is calculated on the aggregate liquidation amount, has been initially set at 5% per annum based upon the current level of Qualified Small Business Lending (QSBL) by the Bank. The dividend rate for future periods will be set based upon the percentage change in qualified lending between each dividend period and the baseline QSBL level established at the time the Agreement was entered into. Such dividend rate may vary from 1% per annum to 5% per annum for the second through tenth dividend periods, and from 1% per annum to 7% per annum for the eleventh through the eighteenth dividend periods. If the Series B Preferred Stock remains outstanding for more than four-and-one-half years, the dividend rate will be fixed at 9%. Prior to that time, in general, the dividend rate decreases as the level of the Bank s QSBL increases. Such dividends are not cumulative, but the Corporation may only declare and pay dividends on its common stock (or any other equity securities junior to the Series B Preferred Stock) if it has declared and paid dividends for the current dividend period on the Series B Preferred Stock, and will be subject to other restrictions on its ability to repurchase or redeem other securities.

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

The Corporation may redeem the shares of Series B Preferred Stock, in whole or in part, at any time at a redemption price equal to the sum of the liquidation amount and the per-share amount of any unpaid dividends for the then-current period, subject to any required prior approval by the Corporation s primary federal banking regulator. If paid in part, payments are required to be at least 25% of the original proceeds.

Under the Agreement, the Corporation also repurchased 7,500 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A (Series A Preferred Stock), issued on December 23, 2008 to the U.S. Treasury in association with participation in the TARP Capital Purchase Plan (TARP/CPP) of the Emergency Economic Stabilization Act of 2008 (EESA). The Series A Preferred Stock was fully repurchased for the sum of the liquidation amount of $1,000 per share and all accrued and unpaid dividends then due, for a total repurchase amount of $7.5 million.

As part of the 2008 TARP transaction, the Corporation issued a warrant to the U.S. Treasury to purchase 50,111 shares of the Corporation s common stock, par value $1.25 per share, for $22.45 per share over a 10-year term. On December 7, 2011, the Corporation repurchased the warrant from the U.S. Treasury for a purchase price of $51,000.

3. Participation in the Small Business Lending Fund (SBLF) ofthe U.S. Treasury Department (U.S. Treasury) and R

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

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, 2011:				
U.S. Treasury and federal agency	$ 3,944	$ 516	$	$ 4,460
U.S. government sponsored entities and agencies	41,425	102	(7)	41,520
Mortgage-backed securities: residential	35,651	1,827		37,478
State and political subdivision	35,073	1,928	(1)	37,000
Equity securities	2,595	308	(207)	2,696
	$ 118,688	$ 4,681	$ (215)	$ 123,154
December 31, 2010:				
U.S. Treasury and federal agency	$ 6,839	$ 6	$ (116)	$ 6,729
U.S. government sponsored entities and agencies	62,770	79	(487)	62,362
Mortgage-backed securities: residential	19,015	370	(5)	19,380
Collateralized mortgage obligations: residential	917	5		922
State and political subdivision	33,477	589	(164)	33,902
Equity securities	2,542		(17)	2,525
	$ 125,560	$ 1,049	$ (789)	$ 125,820

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

(Dollar amounts in thousands)	2011	2010
Proceeds	$ 28,978	$ 43,809
Gains	523	1,030
Losses	(41)	
Tax provision related to gains	164	350

The following table summarizes scheduled maturities of the Corporation s debt securities as of December 31, 2011. 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. Mortgage-backed securities are not due at a single maturity and are shown separately.

	Available for sale	
(Dollar amounts in thousands)	Amortized Cost	Fair Value
Due after one year through five years	$ 5,343	$ 5,538
Due after five through ten years	25,371	27,040
Due after ten years	49,728	50,402

Mortgage-backed securities	35,651	37,478
	$ 116,093	$ 120,458

Securities with carrying values of $62.2 million and $48.2 million as of December 31, 2011 and 2010, 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, 2011 and 2010 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

4. Securities (continued)

	Less than 12 Months		12 Months or More		Total	
(Dollar amounts in thousands)	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
Description of Securities	Value	Loss	Value	Loss	Value	Loss
December 31, 2011:						
U.S. government sponsored entities and agencies	$4,490	$ (7)	$	$	$4,490	$ (7)
State and political subdivision	99	(1)			99	(1)
Equity securities	881	(185)	187	(22)	1,068	(207)
	$5,470	$ (193)	$187	$ (22)	$5,657	$ (215)
December 31, 2010:						
U.S. Treasury and federal agency	$4,814	$ (116)	$	$	$4,814	$ (116)
U.S. government sponsored entities and agencies	43,291	(487)			43,291	(487)
Mortgage-backed securities: residential	1,994	(5)			1,994	(5)
State and political subdivision	8,685	(164)			8,685	(164)
Equity securities	14	(2)	152	(15)	166	(17)
	$58,798	$ (774)	$152	$ (15)	$58,950	$ (789)

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic, market or other 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) whether the market decline was affected by macroeconomic conditions and (4) whether the Corporation has the intent to sell the debt security or more likely than not will be required to sell the security before recovery of its amortized cost basis. If the Corporation intends to sell an impaired security, or if it is more likely than not the Corporation will be required to sell the security before its anticipated recovery, 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. For equity securities determined to be other-than-temporarily impaired, the entire amount of impairment is recognized through earnings.

There were six equity securities in an unrealized loss position as of December 31, 2011. Equity securities owned by the Corporation consist of common stock of various financial service providers. These investment securities are in an unrealized loss position as a result of recent market volatility and depressed pricing of the financial services sector. The Corporation does not invest in these securities with the intent to sell them for a profit in the near term. 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 a review of the profitability and capital adequacy and all other information available to determine the financial position and near term prospects of each issuer. The results of analyzing the aforementioned metrics and financial fundamentals suggest recovery of amortized cost as the sector improves. 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 the

equity securities with unrealized losses as of December 31, 2011 to be other-than-temporarily impaired.

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

4. Securities (continued)

There were five debt securities in an unrealized loss position as of December 31, 2011, all of which were in an unrealized loss position for less than 12 months. Of these securities, four were U.S. government sponsored entities and agencies securities and one was a state and political subdivisions security. The unrealized losses associated with these securities were not due to the deterioration in the credit quality of the issuer that is likely to result in the non-collection of contractual principal and interest, but rather have been caused by a rise in interest rates from the time the securities were purchased. 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 the debt securities with unrealized losses as of December 31, 2011 to be other-than-temporarily impaired.

During 2010, after evaluation of the securities portfolio, management determined that OTTI 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 December 31, 2010 and the resulting impairment losses of $55,000 were recognized in earnings during the fourth quarter of 2010.

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, 2011:				
Debt securities	$ 523	$ (41)	$	$ 482
Year ended December 31, 2010:				
Equity securities	$ 87	$	$ (55)	$ 32
Debt securities	943			943
	$ 1,030	$	$ (55)	$ 975

5. Loans Receivable and Related Allowance for Loan Losses

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

(Dollar amounts in thousands)	2011	2010
Mortgage loans on real estate:		
Residential first mortgages	$ 93,610	$ 84,575
Home equity loans and lines of credit	71,238	75,458
Commercial real estate	94,765	93,028
	259,613	253,061

Other loans:		
Commercial business	43,826	43,780
Consumer	12,642	13,443
	56,468	57,223
Total loans, gross	316,081	310,284
Less allowance for loan losses	3,536	4,132
Total loans, net	$ 312,545	$ 306,152

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

5. Loans Receivable and Related Allowance for Loan Losses (continued)

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

(Dollar amounts in thousands)	2011	2010
Loans with no allocated allowance for loan losses	$ 3,391	$ 2,209
Loans with allocated allowance for loan losses	652	3,215
Total impaired loans	$ 4,043	$ 5,424
Amount of the allowance for loan losses allocated	$ 164	$ 1,246

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of December 31, 2011:

	Impaired Loans with Specific Allowance					
(Dollar amounts in thousands)	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized
Residential first mortgages	$	$	$	$	$	$
Home equity and lines of credit						
Commercial real estate	524	524	142	616	39	26
Commercial business	128	128	22	771	7	2
Consumer						
Total	$652	$ 652	$ 164	$ 1,387	$ 46	$ 28

	Impaired Loans with No Specific Allowance				
	Unpaid Principal Balance	Recorded Investment	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized
Residential first mortgages	$	$	$	$	$
Home equity and lines of credit					
Commercial real estate	1,518	1,154	862	81	81
Commercial business	357	332	122	27	6
Consumer	1,905	1,905	2,018	138	138
Total	$3,780	$ 3,391	$ 3,002	$ 246	$ 225

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of December 31, 2010:

(Dollar amounts in thousands)	Impaired Loans with Specific Allowance			Impaired Loans with No Specific Allowance	
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Unpaid Principal Balance	Recorded Investment
Residential first mortgages	$	$	$	$	$
Home equity and lines of credit					
Commercial real estate	1,994	1,769	387		
Commercial business	1,446	1,446	859	98	73
Consumer				2,136	2,136
Total impaired loans	$ 3,440	$ 3,215	$ 1,246	$ 2,234	$ 2,209

During 2010, impaired loans averaged $2.1 million. The Corporation recognized interest income on impaired loans of approximately $371,000, on a cash basis, during 2010.

Unpaid principal balance includes any loans that have been partially charged off but not forgiven. Accrued interest is not included in the recorded investment in loans based on the amounts not being material.

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

5. Loans Receivable and Related Allowance for Loan Losses (continued)

Troubled debt restructurings (TDR). The Corporation has certain loans that have been modified in order to maximize collection of loan balances. If, for economic or legal reasons related to the customer s financial difficulties, management grants a concession compared to the original terms and conditions of the loan that it would not have otherwise considered, the modified loan is classified as a TDR. Concessions related to TDRs generally do not include forgiveness of principal balances. The Corporation generally does not extend additional credit to borrowers with loans classified as TDRs.

At December 31, 2011 and 2010, the Corporation had $794,000 and $774,000, respectively, of loans classified as TDR s, which are included in impaired loans above. At December 31, 2011 and 2010, the Corporation had $35,000 and $115,000, respectively, of the allowance for loan losses allocated to these specific loans.

During the year ended December 31, 2011, the corporation restructured two commercial real estate loans to one borrower with a principal balance of $352,000. These loans were modified by forbearing the interest amounts then outstanding and establishing a new repayment date and amortization schedule. At December 31, 2011, the Corporation had $35,000 of the allowance for loan losses allocated to these specific loans.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms. There were no defaults on loans classified as TDRs during the year ended December 31, 2011.

Credit Quality Indicators. Management categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors.

Commercial real estate and commercial business loans not identified as impaired are evaluated as risk rated pools of loans utilizing a risk rating practice that is supported by a quarterly special asset review. In this review process, strengths and weaknesses are identified, evaluated and documented for each criticized and classified loan and borrower, strategic action plans are developed, risk ratings are confirmed and the loan s performance status reviewed.

Management has determined certain portions of the loan portfolio to be homogeneous in nature and assigns like reserve factors for the following loan pool types: residential real estate, home equity loans and lines of credit, and consumer installment and personal lines of credit.

The reserve allocation for risk rated loan pools is developed by applying the following factors:

Historic: Management utilizes a computer model to develop the historical net charge-off experience which is used to formulate the assumptions employed in the migration analysis applied to estimate future losses in the portfolio. Outstanding balance and charge-off information are input into the model and historical loss migration rate assumptions are developed to apply to pass, special mention, substandard and doubtful risk rated loans. Normally, a twelve-quarter rolling weighted-average is utilized to anticipate probable incurred losses in the portfolios.

Qualitative: Qualitative adjustment factors for pass, special mention, substandard and doubtful ratings are developed and applied to risk rated loans to allow for: quality of lending policies and procedures; national and local economic and business conditions; changes in the nature and volume of the portfolio; experiences, ability and depth of lending management; changes in trends, volume and severity of past due, nonaccrual and classified loans and loss and recovery trends; quality of loan review systems; concentrations of credit and other external factors.

Management uses the following definitions for risk ratings:

Pass: Loans classified as pass typically exhibit good payment performance and have underlying borrowers with acceptable financial trends where repayment capacity is evident. These borrowers typically would have a sufficient cash flow that would allow them to weather an economic downturn and the value of any underlying collateral could withstand a moderate degree of depreciation due to economic conditions.

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

5. Loans Receivable and Related Allowance for Loan Losses (continued)

Special Mention: Loans classified as special mention are characterized by potential weaknesses that could jeopardize repayment as contractually agreed. These loans may exhibit adverse trends such as increasing leverage, shrinking profit margins and/or deteriorating cash flows. These borrowers would inherently be more vulnerable to the application of economic pressures.

Substandard: Loans classified as substandard exhibit weaknesses that are well-defined to the point that repayment is jeopardized. Typically, the Corporation is no longer adequately protected by both the apparent net worth and repayment capacity of the borrower.

Doubtful: Loans classified as doubtful have advanced to the point that collection or liquidation in full, on the basis of currently ascertainable facts, conditions and value, is highly questionable or improbable.

The following table presents the classes of the loan portfolio summarized by the aggregate pass and the criticized categories of special mention, substandard and doubtful within the Corporation s internal risk rating system as of December 31, 2011 and 2010:

(Dollar amounts in thousands)	Not Rated	Pass	Special Mention	Substandard	Doubtful	Total
December 31, 2011:						
Residential first mortgages	$92,612	$	$	$ 998	$	$93,610
Home equity and lines of credit	71,064			174		71,238
Commercial real estate		88,006	3,625	3,134		94,765
Commercial business		41,864	832	1,130		43,826
Consumer	10,737			1,905		12,642
Total	$174,413	$129,870	$ 4,457	$ 7,341	$	$316,081
December 31, 2010:						
Residential first mortgages	$84,045	$	$	$ 530	$	$84,575
Home equity and lines of credit	75,458					75,458
Commercial real estate		86,790	3,021	3,217		93,028
Commercial business		40,625	1,081	2,030	44	43,780
Consumer	10,953			2,490		13,443
Total	$170,456	$127,415	$ 4,102	$ 8,267	$ 44	$310,284

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

5. Loans Receivable and Related Allowance for Loan Losses (continued)

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and non-performing loans as of December 31, 2011 and 2010:

	Performing			Nonperforming		
(Dollar amounts in thousands)	Accruing Loans Not Past Due	Accruing 30 59 Days Past Due	Accruing 60 89 Days Past Due	Accruing 90 Days + Past Due	Nonaccrual	Total Loans
December 31, 2011:						
Residential first mortgages	$ 91,400	$ 1,059	$ 153	$ 66	$ 932	$ 93,610
Home equity and lines of credit	70,506	431	127		174	71,238
Commercial real estate	92,632	302			1,831	94,765
Commercial business	43,338	7	10		471	43,826
Consumer	10,488	55	8		2,091	12,642
Total loans	$ 308,364	$ 1,854	$ 298	$ 66	$ 5,499	$ 316,081
December 31, 2010:						
Residential first mortgages	$ 81,888	$ 1,875	$ 281	$ 41	$ 490	$ 84,575
Home equity and lines of credit	74,559	541	21		337	75,458
Commercial real estate	90,809	113	26		2,080	93,028
Commercial business	42,168	102			1,510	43,780
Consumer	11,252	36	2		2,153	13,443
Total loans	$ 300,676	$ 2,667	$ 330	$ 41	$ 6,570	$ 310,284

The following table presents the Corporation s nonaccrual loans by aging category as of December 31, 2011 and 2010:

(Dollar amounts in thousands)	Not Past Due	30 59 Days Past Due	60 89 Days Past Due	90 Days + Past Due	Total Loans
December 31, 2011:					
Residential first mortgages	$	$	$	$ 932	$ 932
Home equity and lines of credit				174	174
Commercial real estate	1,087	92		652	1,831
Commercial business	471				471
Consumer	2,091				2,091
Total loans	$ 3,649	$ 92	$	$ 1,758	$ 5,499
December 31, 2010:					
Residential first mortgages	$	$	$	$ 490	$ 490

Home equity and lines of credit				337	337
Commercial real estate	682	161	813	424	2,080
Commercial business	79	6	1,251	174	1,510
Consumer	2,136			17	2,153
Total loans	$ 2,897	$ 167	$ 2,064	$ 1,442	$ 6,570

An allowance for loan losses (ALL) is maintained to absorb probable incurred losses from the loan portfolio. The ALL is based on management s continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience and the amount of non-performing loans.

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

5. Loans Receivable and Related Allowance for Loan Losses (continued)

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL.

Following is an analysis of the changes in the ALL for the years ended December 31:

(Dollar amounts in thousands)	2011	2010
Balance at the beginning of the year	$ 4,132	$ 3,202
Provision for loan losses	420	1,306
Charge-offs	(1,094)	(552)
Recoveries	78	176
Balance at the end of the year	$ 3,536	$ 4,132

The following table details activity in the ALL and the recorded investment by portfolio segment based on impairment method at December 31, 2011 and 2010:

(Dollar amounts in thousands)	Residential Mortgages	Home Equity & Lines of Credit	Commercial Real Estate	Commercial Business	Consumer	Total
December 31, 2011:						
Beginning Balance	$398	$572	$1,707	$1,323	$132	$4,132
Charge-offs	(224)	(188)	(200)	(415)	(67)	(1,094)
Recoveries	3	1		63	11	78
Provision	655	(65)	230	(381)	(19)	420
Ending Balance	$832	$320	$1,737	$590	$57	$3,536
Ending ALL balance attributable to loans:						
Individually evaluated for impairment			22	142		164
Collectively evaluated for impairment	832	320	1,715	448	57	3,372
Total loans:						
Individually evaluated for impairment			1,678	460	1,905	4,043
Collectively evaluated for impairment	93,610	71,238	93,087	43,366	10,737	312,038
December 31, 2010:						
Beginning Balance	$356	$452	$1,895	$448	$51	$3,202
Charge-offs	(40)	(45)	(61)	(216)	(190)	(552)
Recoveries	2	2	147	5	20	176
Provision	80	163	(274)	1,086	251	1,306
Ending Balance	$398	$572	$1,707	$1,323	$132	$4,132

Ending ALL balance attributable to loans:						
Individually evaluated for impairment			387	859		1,246
Collectively evaluated for impairment	398	572	1,320	464	132	2,886
Total loans:						
Individually evaluated for impairment			1,769	1,519	2,136	5,424
Collectively evaluated for impairment	84,575	75,458	91,259	42,261	11,307	304,860

The allowance for loan losses is based on estimates, and actual losses will vary from current estimates. Management believes that the granularity of the homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date.

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

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, which are carried 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 $2.7 million and $984,000, respectively, at December 31, 2011, and $3.3 million and $838,000, respectively, at December 31, 2010. The FHLB notified member banks in December 2008 that it was suspending dividend payments and the repurchase of capital stock; however, due to its improved financial condition, since the fourth quarter of 2010, the FHLB has repurchased a portion of the Bank s excess capital stock each quarter. The repurchases totaled $611,000 and $173,000, respectively, for the years ended December 31, 2011 and 2010. Offsetting these repurchases were purchases of FRB capital stock of $146,000 and $176,000, respectively, for the years ended December 31, 2011 and 2010.

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, 2011.

7. Premises and Equipment

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

(Dollar amounts in thousands)	2011	2010
Land	$ 1,623	$ 1,623
Buildings and improvements	8,215	7,977
Leasehold improvements	818	773
Furniture, fixtures and equipment	5,533	5,241
Software	2,491	2,434
Construction in progress	560	609
	19,240	18,657
Less: accumulated depreciation and amortization	10,214	9,416
	$ 9,026	$ 9,241

Depreciation and amortization expense for the years ended December 31, 2011 and 2010 were $798,000 and $914,000, respectively.

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

7. Premises and Equipment (continued)

Rent expense under non-cancelable operating lease agreements for the years ended December 31, 2011 and 2010 was $156,000 and $187,000, 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
2012	$ 204
2013	308
2014	313
2015	307
2016	236
Thereafter	1,143
	$ 2,511

During 2011, the Corporation entered into a lease agreement for a newly constructed branch office expected to open during 2012 in Cranberry Township, Pennsylvania. The initial term of the lease will commence on the earlier of the day the premises are open for business to the public or 90 days after the delivery of the premises to the Corporation and will expire on the last day of the month which is 10 years after the commencement date. While timing is uncertain due to construction, the Corporation anticipates taking possession of the property in July 2012 and opening the branch office and beginning lease payments in October 2012. The rent commitments listed above includes $42,000 in 2012, $170,000 per year in years 2013 through 2016 and $1.0 million thereafter for this office.

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)	2011 Gross Carrying Amount	Accumulated Amortization	2010 Gross Carrying Amount	Accumulated Amortization
Goodwill	$ 3,664	$	$ 3,664	$
Core deposit intangibles	4,027	2,447	4,027	2,006
Total	$ 7,691	$ 2,447	$ 7,691	$ 2,006

Goodwill resulted from three previous branch acquisitions. Goodwill represents the excess of the total purchase price paid for the branch acquisitions 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 2011 or 2010.

Also, in connection with the assumption of deposits related to a 2009 branch purchase transaction, the Bank recorded a core deposit intangible of $2.8 million during 2009. This intangible asset amortizes using the double declining

balance method over a weighted average estimated life of nine years and is not estimated to have a significant residual value. The Corporation recorded intangible amortization expense totaling $441,000 and $564,000 in 2011 and 2010, respectively.

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

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
2012	$ 345
2013	270
2014	216
2015	195
2016	195
Thereafter	359
	$ 1,580

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 $1.4 million at December 31, 2011 and 2010, respectively. During 2011, total principal additions and total principal repayments associated with these loans were $144,000 and $229,000, respectively. Deposits from principal officers and directors held by the Bank at December 31, 2011 and 2010 totaled $2.3 million and $6.8 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. During 2011 and 2010, amounts paid to affiliates for such services totaled $202,000 and $59,000, respectively.

10. Deposits

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

(Dollar amounts in thousands)	2011			2010		
Type of accounts	Weighted average rate	Amount	%	Weighted average rate	Amount	%
Non-interest bearing deposits		$ 84,871	20.4 %		$ 75,941	18.5 %
Interest bearing demand deposits	0.19 %	186,107	44.7 %	0.28 %	188,910	46.1 %
Time deposits	2.98 %	145,490	34.9 %	3.25 %	144,807	35.4 %
	1.13 %	$ 416,468	100.0 %	1.28 %	$ 409,658	100.0 %

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

(Dollar amounts in thousands)	Amount	%
2012	$ 40,446	27.8 %
2013	46,995	32.3 %
2014	18,363	12.6 %
2015	13,334	9.2 %
2016	13,999	9.6 %
Thereafter	12,353	8.5 %
	$ 145,490	100.0 %

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

10. Deposits (continued)

The Corporation had a total of $54.5 million and $48.5 million in time deposits of $100,000 or more at December 31, 2011 and 2010, respectively. Scheduled maturities of time deposits of $100,000 or more at December 31, 2011 are as follows:

(Dollar amounts in thousands)	Amount
Less than three months	$ 2,397
Over three months to six months	5,468
Over six months to twelve months	5,116
Over twelve months	41,478
	$ 54,459

11. Borrowed Funds

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

	2011			2010		
(Dollar amounts in thousands)	Balance	Average Balance	Average Rate	Balance	Average Balance	Average Rate
Due within 12 months	$	$ 3,414	4.66 %	$ 5,000	$ 5,022	4.80 %
Due beyond 12 months but within 5 years	15,000	17,068	4.63 %	5,000	11,466	4.13 %
Due beyond 5 years but within 10 years	5,000	5,000	4.09 %	20,000	20,000	4.64 %
	$ 20,000	$ 25,482		$ 30,000	$ 36,488	

Short-term borrowed funds at December 31, 2010 consisted of a $5.0 million advance on a line of credit with a correspondent bank. During 2011, the Corporation repaid the entire outstanding balance on the line but maintains the line s availability. 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, 2011 consisted of four, $5.0 million FHLB term advances. The term advances mature between June 2016 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. Qualified collateral at December 31, 2011 totaled $248.3 million.

The four $5.0 million 10 year term FHLB advances are at initial interest rates of 4.98%, 4.83%, 4.68% and 4.09%, respectively. Two of these borrowings were 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 was 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 was 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
2012	$
2013	
2014	
2015	
2016	15,000
Thereafter	5,000
	$ 20,000

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

11. Borrowed Funds (continued)

In addition to the four, $5.0 million FHLB advances described above, the Corporation s long-term borrowed funds at December 31, 2010 consisted of an additional $5.0 million term advance with a rate of 4.04%, and an original maturity date of June 2013. During 2011, the Corporation elected to payoff this borrowing. In connection with the early retirement of this advances, the Corporation incurred a prepayment penalty of $336,000.

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, 2011 was $139.3 million. In addition, the Corporation has $5.5 million and the Bank has $2.0 million of funds available on unused lines of credit through another correspondent bank.

12. Regulatory Matters

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, 2011, $1.2 million of undistributed earnings of the Bank 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 $3.3 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, 2011, the Corporation had an outstanding balance on this line of $1.1 million.

Minimum Regulatory Capital Requirements

The Bank is 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 Bank must meet specific capital guidelines that involve quantitative measures of its 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.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (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, 2011, 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.

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

12. Regulatory Matters (continued)

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

	December 31, 2011		December 31, 2010	
(Dollar amounts in thousands)	Amount	Ratio	Amount	Ratio
Total capital to risk-weighted assets:				
Actual	$ 45,550	16.25 %	$ 40,850	14.52 %
For capital adequacy purposes	22,422	8.00 %	22,504	8.00 %
To be well capitalized	28,027	10.00 %	28,130	10.00 %
Tier 1 capital to risk-weighted assets:				
Actual	$ 42,046	15.00 %	$ 37,326	13.27 %
For capital adequacy purposes	11,211	4.00 %	11,252	4.00 %
To be well capitalized	16,816	6.00 %	16,878	6.00 %
Tier 1 capital to average assets:				
Actual	$ 42,046	8.69 %	$ 37,326	7.92 %
For capital adequacy purposes	19,347	4.00 %	18,858	4.00 %
To be well capitalized	24,183	5.00 %	23,572	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)	2011	2010
Current	$ 838	$ 634
Deferred	112	167
	$ 950	$ 801

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:

	2011	2010

(Dollar amounts in thousands)	Amount	% Pre-tax Income	Amount	% Pre-tax Income
Provision at statutory tax rate	$1,626	34.0 %	$1,316	34.0 %
Increase (decrease) resulting from:				
Tax free interest, net of disallowance	(552)	(11.5%)	(448)	(11.6%)
Earnings on BOLI	(72)	(1.5%)	(71)	(1.8%)
Other, net	(52)	(1.1%)	4	0.1 %
Provision	$950	19.9 %	$801	20.7 %

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

14. Income Taxes (continued)

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 or liability as of December 31 relate to the following:

(Dollar amounts in thousands)	2011	2010
Deferred tax assets:		
Allowance for loan losses	$ 1,046	$ 1,305
Funded status of pension plan	785	484
Securities impairment	226	226
Stock compensation	132	133
Nonaccrual loan interest income	122	146
Other real estate owned	41	7
Other	32	35
Accrued pension cost	23	6
Gross deferred tax assets	2,407	2,342
Deferred tax liabilities:		
Net unrealized gains on securities	1,518	88
Depreciation	618	699
Intangible assets	204	106
Deferred loan fees	79	92
Purchase accounting adjustments	38	50
Prepaid expenses	37	148
Other	3	8
Gross deferred tax liabilities	2,497	1,191
Net deferred tax asset (liability)	$ (90)	$ 1,151

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 or liability is recorded in the consolidated financial statements as a component of other assets or other liabilities.

At December 31, 2011 and December 31, 2010, 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 2008.

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

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)	2011	2010
Change in plan assets:		
Fair value of plan assets at beginning of year	$4,497	$3,987
Actual return on plan assets	192	313
Employer contribution	419	425
Benefits paid	(216)	(228)
Fair value of plan assets at end of year	4,892	4,497
Change in benefit obligation:		
Benefit obligation at beginning of year	5,855	5,131
Service cost	295	292
Interest cost	327	316
Actuarial loss		146
Effect of change in assumptions	749	198
Benefits paid	(216)	(228)
Benefit obligation at end of year	7,010	5,855
Funded status (plan assets less benefit obligation)	$(2,118)	$(1,358)
Amounts recognized in accumulated other comprehensive loss, net of tax, consists of:		
Accumulated net actuarial loss	$1,620	$1,058
Accumulated prior service benefit	(97)	(118)
Amount recognized, end of year	$1,523	$940

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

15. Employee Benefit Plans (continued)

The following table presents the Corporation s pension plan assets measured and recorded at estimated fair value on a recurring basis and their level within the estimated fair value hierarchy as described in Note 17:

(Dollar amounts in thousands) **Description**	Total	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
December 31, 2011:				
Cash and cash equivalents	$ 454	$ 454	$	$
Fixed income	2,471		2,471	
Equity mutual funds domestic	1,758	1,758		
Equity mutual funds international	209	209		
	$ 4,892	$ 2,421	$ 2,471	$
December 31, 2010:				
Cash and cash equivalents	$ 513	$ 513	$	$
Fixed income	1,967		1,967	
Equity mutual funds domestic	1,825	1,825		
Equity mutual funds international	192	192		
	$ 4,497	$ 2,530	$ 1,967	$

There were no significant transfers between Level 1 and Level 2 during 2011.

Amounts recognized in the balance sheet as of December 31 consist of:

	Pension Benefits	
(Dollar amounts in thousands)	2011	2010
Prepaid benefit cost	$ 190	$ 67
Accumulated other comprehensive loss	(2,308)	(1,425)
Net amount recognized	$ (2,118)	$ (1,358)

The accumulated benefit obligation for the defined benefit pension plan was $7.0 million and $5.9 million at December 31, 2011 and 2010, respectively.

The components of the periodic pension costs for the years ended December 31 are as follows:

(Dollar amounts in thousands)	2011	2010
Service cost	$ 295	$ 292
Interest cost	327	316

Expected return on plan assets	(357)	(317)
Amortization of prior service cost and actuarial expense	30	28
Net periodic pension cost	295	319
Amortization of prior service cost	31	28
Amortization of net loss	852	292
Total recognized in other comprehensive (income) loss	883	320
Total recognized in net periodic benefit cost and other comprehensive income	$ 1,178	$ 639

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

15. Employee Benefit Plans (continued)

The estimated net loss and prior service costs for the defined benefit pension plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year is $82,000 as of December 31, 2011.

Weighted-average actuarial assumptions for the years ended December 31 include the following:

	2011	2010
Discount rate for net periodic benefit cost	5.70 %	6.00 %
Discount rate for benefit obligations	4.70 %	5.70 %
Rate of increase in future compensation levels	3.50 %	3.50 %
Expected rate of return on plan assets	7.75 %	7.75 %

The Corporation s pension plan asset allocation at December 31, 2011 and 2010, target allocation for 2012, and expected long-term rate of return by asset category are as follows:

Asset Category	Target Allocation 2012	Percentage of Plan Assets at Year End 2011	2010	Weighted-Average Expected Long-Term Rate of Return 2011
Equity Securities	40 %	40 %	42 %	5.5 %
Debt Securities	50 %	51 %	47 %	1.8 %
Other	10 %	9 %	11 %	0.5 %
	100 %	100 %	100 %	7.75 %

Investment Strategy

The intent of the Plan is to provide a range of investment options for building a diversified asset allocation strategy that will provide the highest likelihood of meeting the aggregate actuarial projections. In selecting the options and asset allocation strategy, the Corporation has determined that the benefits of reduced portfolio risk are best received through diversification. The following asset classes or investment categories are utilized to meet the Plan s objectives: Small company stock, International stock, Mid-cap stock, Large company stock, Diversified bond, Money Market/Stable Value and Cash. The Plan does not prohibit any certain investments.

The Corporation expects to contribute approximately $375,000 to its pension plan in 2012.

Estimated future benefit payments, which reflect expected future service, as appropriate, are as follows:

(Dollar amounts in thousands)	Pension Benefits
For year ended December 31,	
2012	$ 225

2013	226
2014	211
2015	214
2016	253
2017 2021	1,553
Thereafter	4,328
Benefit Obligation	$ 7,010

Certain accounting guidance requires an employer to recognize the funded status of its defined benefit pension plan as a net asset or liability in its consolidated balance sheet with an offsetting amount in accumulated other comprehensive income, and to recognize changes in that funded status in the year in which changes occur through comprehensive income. As of December 31, 2011, the Corporation s liability under this guidance was $2.3 million and the charge to accumulated other comprehensive income was $1.5 million, net of taxes.

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

15. Employee Benefit Plans (continued)

Additionally, the guidance requires an employer to measure the funded status of its defined benefit pension plan as of the date of its year-end financial statements. The Corporation measures the funded status at December 31.

Defined Contribution Plan

The Corporation maintains a defined contribution 401(k) Plan. Employees are eligible to participate by providing tax-deferred contributions up to 20% of qualified compensation. Employee contributions are vested at all times. The Corporation provides a matching contribution of up to 4% of the participant s salary. Matching contributions were $176,000 for 2011 and 2010.

Supplemental Executive Retirement Plan

During 2003, the Corporation established a Supplemental Executive Retirement Plan (SERP) to provide certain additional retirement benefits to participating executive officers. The SERP was adopted in order to provide benefits to such executives whose benefits are reduced under the Corporation s tax-qualified benefit plans pursuant to limitations under the Internal Revenue Code. The SERP is subject to certain vesting provisions and provides that the executives shall receive a supplemental retirement benefit if the executive s employment is terminated after reaching the normal retirement age of 65. As of December 31, 2011 and 2010, the Corporation s SERP liability was $627,000 and $503,000, respectively. For the years ended December 31, 2011 and 2010, the Corporation recognized expense of $124,000 and $86,000, respectively, related to the SERP.

16. Stock Compensation Plans

The Corporation s 2007 Stock Incentive Plan and Trust (the Plan), which is shareholder-approved, permits the grant of restricted stock awards and options to its directors, officers and employees for up to 177,496 shares of common stock. Incentive stock options, non-incentive or compensatory stock options and share awards may be granted under the Plan. The exercise price of each option shall at least equal the market price of a share of common stock on the date of grant and have a contractual term of ten years. Options shall vest and become exercisable at the rate, to the extent and subject to such limitations as may be specified by the Corporation. Compensation cost related to share-based payment transactions must be recognized in the financial statements with measurement based upon the fair value of the equity instruments issued.

During 2011 and 2010, 500 and 4,500 options were granted under the plan, respectively. In addition, during 2011 and 2010, the Corporation granted restricted stock awards of 8,000 and 7,750 shares, respectively, with a face value of $121,000 and $127,000, respectively, based on the weighted-average grant date stock prices of $15.17 and $16.33, respectively. These options and restricted stock awards are 100% vested on the third anniversary of the date of grant. For the year ended December 31, 2011 and 2010, the Corporation recognized $98,000 and $127,000, respectively, in stock compensation expense.

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

Weighted-average for the year ended December 31,	2011	2010
Dividend yield	4.25 %	3.29 %
Expected life	10 years	10 years
Expected volatility	18.14 %	15.56 %
Risk-free interest rate	1.99 %	3.23 %

The expected volatility is based on historical stock price fluctuations. The risk-free interest rates for periods within the contractual life of the awards are based on the U.S. Treasury yield curve in effect at the time of the grant. The expected life is based on the maximum term of the options. The dividend yield assumption is based on the Corporation s history and expectation of dividend payouts.

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

16. Stock Compensation Plans (continued)

A summary of option activity under the Plan as of December 31, 2011, and changes during the period then ended is presented below:

	Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Remaining Term (in years)
Outstanding as of January 1, 2011	100,750	$ 24.44	$	6.9
Granted	500	15.06		10.0
Forfeited	(7,250)	22.90		
Outstanding as of December 31, 2011	94,000	$ 24.51	$	6.0
Exercisable as of December 31, 2011	84,000	$ 25.66	$	5.7

A summary of the status of the Corporation s nonvested option shares as of December 31, 2011, and changes during the period then ended is presented below:

	Options	Weighted-Average Grant-date Fair Value
Nonvested at January 1, 2011	25,750	$ 1.89
Granted	500	1.44
Vested	(12,500)	1.67
Forfeited	(3,750)	2.08
Nonvested as of December 31, 2011	10,000	$ 2.07

A summary of the status of the Corporation s nonvested restricted stock awards as of December 31, 2011, and changes during the period then ended is presented below:

	Shares	Weighted-Average Grant-date Fair Value
Nonvested at January 1, 2011	19,000	$ 16.79
Granted	8,000	15.17
Vested	(4,500)	22.50
Forfeited		
Nonvested as of December 31, 2011	22,500	$ 15.07

As of December 31, 2011, there was $234,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plan. That cost is expected to be recognized over the next

three years.

17. Fair Values of Financial Instruments

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

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

17. Fair Values of Financial Instruments (continued)

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair value.

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

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

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

An asset or liability s level is based on the lowest level of input that is significant to the fair value measurement.

The Corporation used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

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

Impaired loans Fair value on impaired loans is measured using the estimate fair market value of the collateral less the estimate costs to sell. Fair value of the loan s collateral is typically determined by appraisals or independent valuation. Management s ongoing review of appraisal information may result in additional discounts or adjustments to the valuation based upon more recent market sales activity or more current appraisal information derived from properties of similar type and/or locale. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. As of December 31, 2011, the fair value of impaired loans consists of loan balances totaling $652,000, net of a valuation allowance of $164,000, compared to loan balances of $3.2 million, net of a valuation allowance of $1.2 million at December 31, 2010. Additional provision for loan losses of $143,000 and $1.1 million was recorded during the years ended December 31, 2011 and 2010, respectively.

Real estate owned Fair value on other real estate owned (OREO) is measured using the estimate fair market value of the collateral less the estimate costs to sell. Fair value of the collateral is typically determined by appraisals or independent valuation. Management s ongoing review of appraisal information may result in additional discounts or adjustments to the valuation based upon more recent market sales activity or more current appraisal information derived from properties of similar type and/or locale. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. As of December 31, 2011, OREO measured at fair value less costs to sell had a net carrying amount of $45,000, which is made up of the outstanding balance of $50,000 and a write-down of $5,000.

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

17. Fair Values of Financial Instruments (continued)

For assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy are as follows:

(Dollar amounts in thousands) **Description**	Total	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
December 31, 2011:				
U.S. Treasury and federal agency	$4,460	$ 4,460	$	$
U.S. government sponsored entities and agencies	41,520		41,520	
Mortgage-backed securities: residential	37,478		37,478	
State and political subdivision	37,000		37,000	
Equity securities	2,696	1,052	1,644	
	$123,154	$ 5,512	$117,642	$
December 31, 2010:				
U.S. Treasury and federal agency	$6,729	$ 6,729	$	$
U.S. government sponsored entities and agencies	62,362		62,362	
Mortgage-backed securities: residential	19,380		19,380	
Collateralized mortgage obligations	922		922	
State and political subdivision	33,902		33,902	
Equity securities	2,525	154	2,371	
	$125,820	$ 6,883	$118,937	$

During 2011, the Corporation transferred one equity security from a Level 2 classification to a Level 1 classification within the fair value hierarchy. This equity security had a fair market value of $853,000 at December 31, 2011, compared to $1.0 million at December 31, 2010.

For assets measured at fair value on a non-recurring basis, the fair value measurements by level within the fair value hierarchy are as follows:

(Dollar amounts in thousands) **Description**	Total	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
December 31, 2011:				

Impaired commercial real estate loans	$ 382	$	$	$ 382
Impaired commercial business loans	106			106
Other residential real estate owned	45			45
	$ 533	$	$	$ 533
December 31, 2010:				
Impaired commercial real estate loans	$ 1,382	$	$	$ 1,382
Impaired commercial business loans	587			587
	$ 1,969	$	$	$ 1,969

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

17. Fair Values of Financial Instruments (continued)

The following table sets forth the carrying amount and fair value of the Corporation s financial instruments included in the consolidated balance sheet as of December 31:

(Dollar amounts in thousands)	2011 Carrying amount	Fair value	2010 Carrying amount	Fair value
Financial assets:				
Cash and cash equivalents	$ 28,193	$ 28,193	$ 19,027	$ 19,027
Securities	123,154	123,154	125,820	125,820
Loans receivable	312,545	319,967	306,152	308,776
Federal bank stocks	3,664	N/A	4,129	N/A
Accrued interest receivable	1,630	1,630	1,763	1,763
Financial liabilities:				
Deposits	416,468	422,704	409,658	415,040
Borrowed funds	20,000	23,362	30,000	33,163
Accrued interest payable	541	541	649	649
Off-balance sheet commitments				

This information should not be interpreted as an estimate of the fair value of the entire Corporation since a fair value calculation is only provided for a limited portion of the Corporation s assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Corporation s disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate fair values of the Corporation s financial instruments at December 31, 2011 and 2010:

Carrying amount is the estimated fair value for cash and cash equivalents, securities, accrued interest receivable and payable, demand deposits, short-term borrowed funds, and variable rate loans or deposits that reprice frequently and fully. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair value of debt is based on current rates for similar financing. It was not practicable to determine the fair value of federal bank stocks due to restrictions placed on its transferability.

Estimates of the fair value of off-balance sheet items were not made because of the short-term nature of these arrangements and the credit standing of the counterparties. Also, unfunded loan commitments relate principally to variable rate commercial loans.

Off-Balance Sheet Financial Instruments

The Corporation is party to credit related financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and commercial letters of credit. Commitments to extend credit involve, to a varying degree, elements of credit and interest rate risk in excess of amounts recognized in the consolidated balance sheets. The Corporation s exposure

to credit loss in the event of non-performance by the other party for commitments to extend credit is represented by the contractual amount of these commitments, less any collateral value obtained. The Corporation uses the same credit policies in making commitments as for on-balance sheet instruments. The Corporation s distribution of commitments to extend credit approximates the distribution of loans receivable outstanding.

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

17. Fair Values of Financial Instruments (continued)

The following table presents the notional amount of the Corporation s off-balance sheet commitment financial instruments as of December 31:

(Dollar amounts in thousands)	2011 Fixed Rate	Variable Rate	2010 Fixed Rate	Variable Rate
Commitments to make loans	$ 2,967	$ 953	$ 4,073	$ 5,023
Unused lines of credit	3,703	36,166	888	35,903
	$ 6,670	$ 37,119	$ 4,961	$ 40,926

Commitments to make loans are generally made for periods of 30 days or less. The fixed rate loan commitments at December 31, 2011 have interest rates ranging from 3.125% to 4.75%. Commitments to extend credit include agreements to lend to a customer as long as there is no violation of any condition established in the contract. These commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Commitments to extend credit also include unfunded commitments under commercial and consumer lines of credit, revolving credit lines and overdraft protection agreements. These lines of credit may be collateralized and usually do not contain a specified maturity date and may be drawn upon to the total extent to which the Corporation is committed.

Standby letters of credit are conditional commitments issued by the Corporation usually for commercial customers to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Corporation generally holds collateral supporting those commitments if deemed necessary. Standby letters of credit were $245,000 and $648,000 at December 31, 2011 and 2010, respectively. The current amount of the liability as of December 31, 2011 and 2010 for guarantees under standby letters of credit issued is not material.

18. Emclaire Financial Corp. Condensed Financial Statements, Parent Corporation Only

Following are condensed financial statements for the parent company as of and for the years ended December 31:

Condensed Balance Sheets ***(Dollar amounts in thousands)***	2011	2010
Assets:		
Cash and cash equivalents	$ 87	$ 55
Securities available for sale	2,644	2,473
Equity in net assets of subsidiaries	48,625	42,292
Other assets	515	451
Total Assets	$ 51,871	$ 45,271
Liabilities and Stockholders Equity:		

Short-term borrowed funds with affiliated subsidiary bank	$ 1,100	$ 1,100
Other short-term borrowed funds		5,000
Accrued expenses and other liabilities	41	53
Stockholders equity	50,730	39,118
Total Liabilities and Stockholders Equity	$ 51,871	$ 45,271

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

18. Emclaire Financial Corp. Condensed Financial Statements, Parent Corporation Only (continued)

Condensed Statements of Income ***(Dollar amounts in thousands)***	2011	2010
Income:		
Dividends from subsidiaries	$ 4,854	$ 1,569
Investment income	73	110
Total income	4,927	1,679
Expense:		
Interest expense	194	277
Noninterest expense	342	338
Total expense	536	615
Income before income taxes and undistributed subsidiary income	4,391	1,064
Undistributed equity in (distribution in excess of) net income of subsidiary	(652)	1,919
Net income before income taxes	3,739	2,983
Income tax benefit	(94)	(86)
Net income	$ 3,833	$ 3,069
Comprehensive income	$ 6,026	$ 2,732

Condensed Statements of Cash Flows ***(Dollar amounts in thousands)***	2011	2010
Operating activities:		
Net income	$3,833	$3,069
Adjustments to reconcile net income to net cash provided by operating activities:		
(Undistributed equity in) distributions in excess of net income of subsidiary	652	(1,919)
Securities impairment loss recognized in earnings		42
Other, net	(16)	(46)
Net cash provided by operating activities	4,469	1,146
Investing activities:		
Sales (purchases) of investment securities	(52)	501
Investment in subsidiaries	(4,873)	(875)
Net cash used in investing activities	(4,925)	(374)
Financing activities:		
Net change in borrowings	(5,000)	
Proceeds from issuance of common stock	4,576	
Proceeds from issuance of preferred stock (Series B)	10,000	
Redemption of preferred stock (Series A)	(7,500)	
Warrant repurchase	(51)	
Proceeds from reissuance of treasury stock		410
Dividends paid	(1,537)	(1,185)
Net cash provided by (used in) financing activities	488	(775)

Increase (decrease) in cash and cash equivalents	32	(3)
Cash and cash equivalents at beginning of period	55	58
Cash and cash equivalents at end of period	$87	$55

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

19. Other Comprehensive Income (Loss)

Other comprehensive income (loss) components and related taxes for the years ended December 31 were as follows:

(Dollar amounts in thousands)	2011	2010
Net unrealized holding gains on available for sale securities	$ 4,688	$ 784
Reclassification adjustment for gains recognized in income, net	(482)	(975)
Amortization of pension prior service cost	(32)	(30)
Amortization of pension net actuarial loss	(851)	(290)
Net unrealized gains (losses)	3,323	(511)
Tax (expense) benefit	(1,130)	174
Other comprehensive income (loss)	$ 2,193	$ (337)

20. Other Noninterest Income and Expense

Other noninterest income includes customer bank card processing fee income of $818,000 and $608,000 for 2011 and 2010, respectively.

The following summarizes the Corporation s other noninterest expenses for the years ended December 31:

(Dollar amounts in thousands)	2011	2010
Customer bank card processing	$ 365	$ 271
Penalties on prepayment of FHLB advances	334	557
Telephone and data communications	292	294
Internet banking and bill pay	234	227
Other	220	114
Travel, entertainment and conferences	215	207
Pennsylvania shares and use taxes	214	221
Printing and supplies	213	230
Postage and freight	173	201
Contributions	172	121
Marketing and advertising	171	153
Correspondent bank and courier fees	160	170
Subscriptions	151	136
Collections	132	94
Examinations	130	126
Total other noninterest expenses	$ 3,176	$ 3,122

TABLE OF CONTENTS

Notes to Consolidated Financial Statements

21. Earnings Per Share

The factors used in the Corporation s earnings per share computation follow:

(Dollar amounts in thousands, except for per share amounts)	For the year ended December 31, 2011	2010
Earnings per common share basic		
Net income	$3,833	$3,069
Less: Preferred stock dividends and discount accretion	517	393
Net income available to common stockholders	$3,316	$2,676
Average common shares outstanding	1,677,225	1,444,725
Basic earnings per common share	$1.98	$1.85
Earnings per common share diluted		
Net income available to common stockholders	$3,316	$2,676
Average common shares outstanding	1,677,225	1,444,725
Add: Dilutive effects of assumed exercises of stock options		1,935
Average shares and dilutive potential common shares	1,677,225	1,446,660
Diluted earnings per common share	$1.98	$1.85
Stock options, restricted stock awards and warrants not considered in computing diluted earnings per share because they were antidilutive	116,500	155,111