

CNB FINANCIAL CORP/PA  
Form 10-Q  
August 05, 2011  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10 - Q**

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

For the quarterly period ended June 30, 2011

or

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

For the transition period from            to

Commission File Number 000-13396

**CNB FINANCIAL CORPORATION**

(Exact name of registrant as specified in its charter)

**Pennsylvania**  
(State or other jurisdiction of  
incorporation or organization)

**25-1450605**  
(I.R.S. Employer  
Identification No.)

**1 South Second Street**

**P.O. Box 42**

**Clearfield, Pennsylvania 16830**

(Address of principal executive offices)

**Registrant's telephone number, including area code, (814) 765-9621**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

The number of shares outstanding of the issuer's common stock as of August 5, 2011

COMMON STOCK NO PAR VALUE PER SHARE: 12,313,319 SHARES

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**PART I.**

**FINANCIAL INFORMATION**

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**Forward-Looking Statements**

This document contains 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, with respect to our financial condition, liquidity, results of operations, future performance and business. These forward-looking statements are intended to be covered by the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are those that are not historical facts. Forward-looking statements include statements with respect to beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions that are subject to significant risks and uncertainties and are subject to change based on various factors (some of which are beyond our control). Forward-looking statements often include words such as believes, expects, anticipates, estimates, intends, plans or similar expressions or future conditional verbs such as may, will, should, would and could. Such known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from the statements include, but are not limited to: changes in general business, industry or economic conditions or competition; changes in any applicable law, rule, regulation, policy, guideline or practice governing or affecting financial holding companies and their subsidiaries or with respect to tax or accounting principles or otherwise; adverse changes or conditions in capital and financial markets; changes in interest rates; higher than expected costs or other difficulties related to integration of combined or merged businesses; the inability to realize expected cost savings or achieve other anticipated benefits in connection with business combinations and other acquisitions; changes in the quality or composition of our loan and investment portfolios; adequacy of loan loss reserves; increased competition; loss of certain key officers; continued relationships with major customers; deposit attrition; rapidly changing technology; unanticipated regulatory or judicial proceedings and liabilities and other costs; changes in the cost of funds, demand for loan products or demand for financial services; and other economic, competitive, governmental or technological factors affecting our operations, markets, products, services and prices. Some of these and other factors are discussed in our annual and quarterly reports filed with the Securities and Exchange Commission. Such factors could cause actual results to differ materially from those in the forward-looking statements.

The forward-looking statements are based upon management's beliefs and assumptions and are made as of the date of the filing of this document. We undertake no obligation to publicly update or revise any forward-looking statements included in this document or to update the reasons why actual results could differ from those contained in such statements, whether as a result of new information, future events or otherwise, except to the extent required by law. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this document might not occur and you should not put undue reliance on any forward-looking statements.

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## Part I Financial Information

## Item 1. Financial Statements

## CONSOLIDATED BALANCE SHEETS

Dollars in thousands

|                                                                                                   | (unaudited)         |                      |
|---------------------------------------------------------------------------------------------------|---------------------|----------------------|
|                                                                                                   | June 30,<br>2011    | December 31,<br>2010 |
| <b><u>ASSETS</u></b>                                                                              |                     |                      |
| Cash and due from banks                                                                           | \$ 30,238           | \$ 24,584            |
| Interest bearing deposits with other banks                                                        | 13,379              | 12,848               |
| Total cash and cash equivalents                                                                   | 43,617              | 37,432               |
| Interest bearing time deposits with other banks                                                   | 1,622               | 2,817                |
| Securities available for sale                                                                     | 548,164             | 500,677              |
| Trading securities                                                                                | 2,441               | 2,351                |
| Loans held for sale                                                                               | 2,706               | 4,451                |
| Loans                                                                                             | 824,455             | 797,009              |
| Less: unearned discount                                                                           | (2,668)             | (2,447)              |
| Less: allowance for loan losses                                                                   | (11,715)            | (10,820)             |
| Net loans                                                                                         | 810,072             | 783,742              |
| FHLB and other equity interests                                                                   | 6,581               | 6,415                |
| Premises and equipment, net                                                                       | 24,661              | 24,135               |
| Bank owned life insurance                                                                         | 25,203              | 19,742               |
| Mortgage servicing rights                                                                         | 912                 | 908                  |
| Goodwill                                                                                          | 10,821              | 10,821               |
| Accrued interest receivable and other assets                                                      | 14,394              | 20,020               |
| <b>TOTAL</b>                                                                                      | <b>\$ 1,491,194</b> | <b>\$ 1,413,511</b>  |
| <b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>                                                |                     |                      |
| Non-interest bearing deposits                                                                     | \$ 148,022          | \$ 140,836           |
| Interest bearing deposits                                                                         | 1,101,050           | 1,022,032            |
| Total deposits                                                                                    | 1,249,072           | 1,162,868            |
| Treasury, tax and loan borrowings                                                                 | 1,080               | 1,248                |
| FHLB and other borrowings                                                                         | 82,008              | 105,259              |
| Subordinated debentures                                                                           | 20,620              | 20,620               |
| Accrued interest payable and other liabilities                                                    | 16,184              | 13,871               |
| Total liabilities                                                                                 | 1,368,964           | 1,303,866            |
| Common stock, \$0 par value; authorized 50,000,000 shares; issued 12,599,603 shares               | 0                   | 0                    |
| Additional paid in capital                                                                        | 44,437              | 44,676               |
| Retained earnings                                                                                 | 76,175              | 73,059               |
| Treasury stock, at cost (293,964 shares at June 30, 2011 and 362,342 shares at December 31, 2010) | (4,364)             | (5,417)              |
| Accumulated other comprehensive income (loss)                                                     | 5,982               | (2,673)              |

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|                            |                     |                     |
|----------------------------|---------------------|---------------------|
| Total shareholders' equity | 122,230             | 109,645             |
| <b>TOTAL</b>               | <b>\$ 1,491,194</b> | <b>\$ 1,413,511</b> |

See Notes to Consolidated Financial Statements

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## CONSOLIDATED STATEMENTS OF INCOME (unaudited)

Dollars in thousands, except per share data

|                                                                                                      | Three months ended<br>June 30, |            |
|------------------------------------------------------------------------------------------------------|--------------------------------|------------|
|                                                                                                      | 2011                           | 2010       |
| <b>INTEREST AND DIVIDEND INCOME:</b>                                                                 |                                |            |
| Loans including fees                                                                                 | \$ 11,962                      | \$ 11,815  |
| Deposits with banks                                                                                  | 40                             | 31         |
| Securities:                                                                                          |                                |            |
| Taxable                                                                                              | 3,693                          | 2,929      |
| Tax-exempt                                                                                           | 714                            | 547        |
| Dividends                                                                                            | 8                              | 6          |
| <br>Total interest and dividend income                                                               | <br>16,417                     | <br>15,328 |
| <b>INTEREST EXPENSE:</b>                                                                             |                                |            |
| Deposits                                                                                             | 3,501                          | 3,368      |
| Borrowed funds                                                                                       | 808                            | 1,079      |
| Subordinated debentures                                                                              | 196                            | 196        |
| <br>Total interest expense                                                                           | <br>4,505                      | <br>4,643  |
| <br>NET INTEREST INCOME                                                                              | <br>11,912                     | <br>10,685 |
| PROVISION FOR LOAN LOSSES                                                                            | 992                            | 1,161      |
| <br>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES                                              | <br>10,920                     | <br>9,524  |
| <b>NON-INTEREST INCOME:</b>                                                                          |                                |            |
| Wealth and asset management fees                                                                     | 395                            | 429        |
| Service charges on deposit accounts                                                                  | 1,069                          | 1,052      |
| Other service charges and fees                                                                       | 416                            | 373        |
| Net realized and unrealized losses on securities for which fair value was elected                    | (16)                           | (210)      |
| Mortgage banking                                                                                     | 155                            | 48         |
| Bank owned life insurance                                                                            | 212                            | 200        |
| Other                                                                                                | 385                            | 293        |
|                                                                                                      | 2,616                          | 2,185      |
| <br>Total other-than-temporary impairment losses on available-for-sale securities                    | <br>0                          | <br>(318)  |
| Less portion of loss recognized in other comprehensive income                                        | 0                              | 0          |
| Net impairment losses recognized in earnings                                                         | 0                              | (318)      |
| Net realized gains on available-for-sale securities                                                  | 0                              | 141        |
| <br>Net impairment losses recognized in earnings and realized gains on available-for-sale securities | <br>0                          | <br>(177)  |
| <br>Total non-interest income                                                                        | <br>2,616                      | <br>2,008  |
| <b>NON-INTEREST EXPENSES:</b>                                                                        |                                |            |
| Salaries and benefits                                                                                | 4,197                          | 3,714      |
| Net occupancy expense of premises                                                                    | 1,103                          | 1,016      |
| FDIC insurance premiums                                                                              | 280                            | 386        |

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|                                   |                 |                 |
|-----------------------------------|-----------------|-----------------|
| Amortization of intangibles       | 0               | 25              |
| Other                             | 2,561           | 2,190           |
| Total non-interest expenses       | 8,141           | 7,331           |
| <b>INCOME BEFORE INCOME TAXES</b> | <b>5,395</b>    | <b>4,201</b>    |
| INCOME TAX EXPENSE                | 1,504           | 1,077           |
| <b>NET INCOME</b>                 | <b>\$ 3,891</b> | <b>\$ 3,124</b> |
| <b>EARNINGS PER SHARE:</b>        |                 |                 |
| Basic                             | \$ 0.32         | \$ 0.34         |
| Diluted                           | \$ 0.32         | \$ 0.34         |
| <b>DIVIDENDS PER SHARE:</b>       |                 |                 |
| Cash dividends per share          | \$ 0.165        | \$ 0.165        |

See Notes to Consolidated Financial Statements



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## CONSOLIDATED STATEMENTS OF INCOME (unaudited)

Dollars in thousands, except per share data

|                                                                                                      | Six months ended |             |
|------------------------------------------------------------------------------------------------------|------------------|-------------|
|                                                                                                      | June 30,         |             |
|                                                                                                      | 2011             | 2010        |
| <b>INTEREST AND DIVIDEND INCOME:</b>                                                                 |                  |             |
| Loans including fees                                                                                 | \$ 23,667        | \$ 23,127   |
| Deposits with banks                                                                                  | 82               | 63          |
| Securities:                                                                                          |                  |             |
| Taxable                                                                                              | 6,951            | 5,269       |
| Tax-exempt                                                                                           | 1,396            | 1,023       |
| Dividends                                                                                            | 15               | 14          |
| <br>Total interest and dividend income                                                               | <br>32,111       | <br>29,496  |
| <b>INTEREST EXPENSE:</b>                                                                             |                  |             |
| Deposits                                                                                             | 6,936            | 6,808       |
| Borrowed funds                                                                                       | 1,577            | 2,177       |
| Subordinated debentures                                                                              | 387              | 385         |
| <br>Total interest expense                                                                           | <br>8,900        | <br>9,370   |
| <br>NET INTEREST INCOME                                                                              | <br>23,211       | <br>20,126  |
| PROVISION FOR LOAN LOSSES                                                                            | 1,769            | 1,746       |
| <br>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES                                              | <br>21,442       | <br>18,380  |
| <b>NON-INTEREST INCOME:</b>                                                                          |                  |             |
| Wealth and asset management fees                                                                     | 810              | 824         |
| Service charges on deposit accounts                                                                  | 2,032            | 1,997       |
| Other service charges and fees                                                                       | 768              | 674         |
| Net realized and unrealized gains (losses) on securities for which fair value was elected            | 97               | (90)        |
| Mortgage banking                                                                                     | 334              | 249         |
| Bank owned life insurance                                                                            | 461              | 402         |
| Other                                                                                                | 625              | 553         |
|                                                                                                      | 5,127            | 4,609       |
| <br>Total other-than-temporary impairment losses on available-for-sale securities                    | <br>(398)        | <br>(1,102) |
| Less portion of loss recognized in other comprehensive income                                        | 0                | 0           |
| <br>Net impairment losses recognized in earnings                                                     | <br>(398)        | <br>(1,102) |
| Net realized gains on available-for-sale securities                                                  | 74               | 573         |
| <br>Net impairment losses recognized in earnings and realized gains on available-for-sale securities | <br>(324)        | <br>(529)   |
| <br>Total non-interest income                                                                        | <br>4,803        | <br>4,080   |
| <b>NON-INTEREST EXPENSES:</b>                                                                        |                  |             |
| Salaries and benefits                                                                                | 8,440            | 7,691       |

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|                                   |                 |                 |
|-----------------------------------|-----------------|-----------------|
| Net occupancy expense of premises | 2,302           | 2,151           |
| FDIC insurance premiums           | 729             | 775             |
| Amortization of intangibles       | 0               | 50              |
| Other                             | 4,961           | 4,791           |
| Total non-interest expenses       | 16,432          | 15,458          |
| <b>INCOME BEFORE INCOME TAXES</b> | <b>9,813</b>    | <b>7,002</b>    |
| INCOME TAX EXPENSE                | 2,645           | 1,718           |
| <b>NET INCOME</b>                 | <b>\$ 7,168</b> | <b>\$ 5,284</b> |
| <b>EARNINGS PER SHARE:</b>        |                 |                 |
| Basic                             | \$ 0.58         | \$ 0.59         |
| Diluted                           | \$ 0.58         | \$ 0.58         |
| <b>DIVIDENDS PER SHARE:</b>       |                 |                 |
| Cash dividends per share          | \$ 0.33         | \$ 0.33         |

See Notes to Consolidated Financial Statements

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## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

Dollars in thousands

|                                                                                                                                                                                                                                        | Three months ended<br>June 30, |                 | Six months ended<br>June 30, |                  |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------|-----------------|------------------------------|------------------|
|                                                                                                                                                                                                                                        | 2011                           | 2010            | 2011                         | 2010             |
| <b>NET INCOME</b>                                                                                                                                                                                                                      | <b>\$ 3,891</b>                | <b>\$ 3,124</b> | <b>\$ 7,168</b>              | <b>\$ 5,284</b>  |
| Other comprehensive income, net of tax:                                                                                                                                                                                                |                                |                 |                              |                  |
| Change in fair value of interest rate swap agreements designated as cash flow hedges, net of tax of \$78 and \$50 for the three months ended June 30, 2011 and 2010, and \$42 and \$82 for the six months ended June 30, 2011 and 2010 | (145)                          | (93)            | (78)                         | (152)            |
| Net change in unrealized gains (losses) on securities available for sale:                                                                                                                                                              |                                |                 |                              |                  |
| Unrealized gains (losses) on other-than-temporarily impaired securities available for sale:                                                                                                                                            |                                |                 |                              |                  |
| Unrealized losses arising during the period, net of tax of \$129 for the three months ended June 30, 2010, and (\$32) and \$135 for the six months ended June 30, 2011 and 2010                                                        | 0                              | (240)           | 60                           | (251)            |
| Reclassification adjustment for losses included in net income, net of tax of (\$111) for the three months ended June 30, 2010, and (\$139) and (\$386) for the six months ended June 30, 2011 and 2010                                 | 0                              | 207             | 259                          | 716              |
|                                                                                                                                                                                                                                        | 0                              | (33)            | 319                          | 465              |
| Unrealized gains (losses) on other securities available for sale:                                                                                                                                                                      |                                |                 |                              |                  |
| Unrealized gains arising during the period, net of tax of (\$3,881) and (\$2,151) for the three months ended June 30, 2011 and 2010, and (\$4,556) and (\$2,777) for the six months ended June 30, 2011 and 2010                       | 7,208                          | 3,994           | 8,462                        | 5,158            |
| Reclassification adjustment for accumulated gains included in net income, net of tax of \$50 for the three months ended ended June 30, 2010, and \$26 and \$200 for the six months ended June 30, 2011 and 2010                        | 0                              | (92)            | (48)                         | (372)            |
|                                                                                                                                                                                                                                        | 7,208                          | 3,902           | 8,414                        | 4,786            |
| Other comprehensive income                                                                                                                                                                                                             | 7,063                          | 3,776           | 8,655                        | 5,099            |
| <b>COMPREHENSIVE INCOME</b>                                                                                                                                                                                                            | <b>\$ 10,954</b>               | <b>\$ 6,900</b> | <b>\$ 15,823</b>             | <b>\$ 10,383</b> |

See Notes to Consolidated Financial Statements

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## CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

Dollars in thousands

|                                                                                                | Six months ended |                  |
|------------------------------------------------------------------------------------------------|------------------|------------------|
|                                                                                                | June 30,         |                  |
|                                                                                                | 2011             | 2010             |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                                   |                  |                  |
| Net income                                                                                     | \$ 7,168         | \$ 5,284         |
| Adjustments to reconcile net income to net cash provided by operations:                        |                  |                  |
| Provision for loan losses                                                                      | 1,769            | 1,746            |
| Depreciation and amortization                                                                  | 1,016            | 1,017            |
| Amortization, accretion and deferred loan fees and costs                                       | 1,337            | 1,054            |
| Net impairment losses realized in earnings and gains on sales of available-for-sale securities | 324              | 529              |
| Net realized and unrealized gains on securities for which fair value was elected               | (97)             | 90               |
| Proceeds from sale of securities for which fair value was elected                              | 170              | 0                |
| Purchase of securities for which fair value was elected                                        | (197)            | 0                |
| Gain on sale of loans                                                                          | (280)            | (183)            |
| Net gains on dispositions of premises and equipment and foreclosed assets                      | (79)             | (88)             |
| Proceeds from sale of loans                                                                    | 10,953           | 3,695            |
| Origination of loans held for sale                                                             | (9,053)          | (5,750)          |
| Increase in bank owned life insurance                                                          | (461)            | (402)            |
| Stock-based compensation expense                                                               | 102              | 122              |
| Contribution of treasury stock                                                                 | 60               | 0                |
| Changes in:                                                                                    |                  |                  |
| Accrued interest receivable and other assets                                                   | 931              | (1,172)          |
| Accrued interest payable and other liabilities                                                 | 2,193            | 2                |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>                                               | <b>15,856</b>    | <b>5,944</b>     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                                   |                  |                  |
| Net decrease in interest bearing time deposits with other banks                                | 1,195            | 2,721            |
| Proceeds from maturities, prepayments and calls of securities                                  | 49,626           | 52,476           |
| Proceeds from sales of securities                                                              | 23,610           | 38,065           |
| Purchase of securities                                                                         | (108,992)        | (201,759)        |
| Loan origination and payments, net                                                             | (28,091)         | (24,210)         |
| Purchase of bank owned life insurance                                                          | (5,000)          | (2,500)          |
| Redemption (purchase) of FHLB and other equity interests                                       | (166)            | 124              |
| Purchase of premises and equipment                                                             | (1,434)          | (1,307)          |
| Proceeds from the sale of premises and equipment and foreclosed assets                         | 196              | 263              |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>                                                   | <b>(69,056)</b>  | <b>(136,127)</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                                   |                  |                  |
| Net change in:                                                                                 |                  |                  |
| Checking, money market and savings accounts                                                    | 142,321          | 119,787          |
| Certificates of deposit                                                                        | (56,117)         | 18,316           |
| Proceeds from sale of treasury stock                                                           | 652              | 608              |
| Proceeds from exercise of stock options                                                        | 0                | 42               |
| Proceeds from stock offering, net of issuance costs                                            | 0                | 32,414           |
| Cash dividends paid                                                                            | (4,052)          | (2,902)          |
| Proceeds from long-term borrowings                                                             | 350              | 0                |
| Repayment of long-term borrowings                                                              | (61)             | (16,057)         |
| Net change in short-term borrowings                                                            | (23,708)         | (97)             |

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|                                                             |           |           |
|-------------------------------------------------------------|-----------|-----------|
| NET CASH PROVIDED BY FINANCING ACTIVITIES                   | 59,385    | 152,111   |
| NET INCREASE IN CASH AND CASH EQUIVALENTS                   | 6,185     | 21,928    |
| CASH AND CASH EQUIVALENTS, Beginning                        | 37,432    | 22,358    |
| CASH AND CASH EQUIVALENTS, Ending                           | \$ 43,617 | \$ 44,286 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:           |           |           |
| Cash paid during the period for:                            |           |           |
| Interest                                                    | \$ 9,006  | \$ 9,537  |
| Income taxes                                                | 1,493     | 1,986     |
| SUPPLEMENTAL NONCASH DISCLOSURES:                           |           |           |
| Transfers to other real estate owned                        | 69        | 333       |
| Loans transferred from held for sale to held for investment | 0         | 3,321     |
| Grant of restricted stock awards from treasury stock        | 266       | 233       |

See Notes to Consolidated Financial Statements

**Table of Contents****CNB FINANCIAL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(UNAUDITED)****BASIS OF PRESENTATION**

The accompanying consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission (SEC) and in compliance with accounting principles generally accepted in the United States of America (GAAP). Because this report is based on an interim period, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted.

In the opinion of management of the registrant, the accompanying consolidated financial statements as of June 30, 2011 and for the three and six month periods ended June 30, 2011 and 2010 include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial condition and the results of operations for the period. The financial performance reported for CNB Financial Corporation (the Corporation) for the three and six month periods ended June 30, 2011 is not necessarily indicative of the results to be expected for the full year. This information should be read in conjunction with the Corporation's Form 10-K for the period ended December 31, 2010. All amounts are stated in thousands, except share data.

**STOCK COMPENSATION**

The Corporation has a stock incentive plan for key employees and independent directors. The Stock incentive plan, which is administered by a committee of the Board of Directors, provides for up to 500,000 shares of common stock in the form of nonqualified options or restricted stock. For key employees, the plan vesting is one-fourth of the granted options or restricted stock per year beginning one year after the grant date, with 100% vested on the fourth anniversary of the grant. For independent directors, the vesting schedule is one-third of the granted options per year beginning one year after the grant date, with 100% vested on the third anniversary of the grant.

At June 30, 2011, there was no unrecognized compensation cost related to nonvested stock options granted under this plan, and no stock options were granted during the three month period then ended.

Compensation expense for the restricted stock awards is recognized over the requisite service period noted above based on the fair value of the shares at the date of grant. Unearned restricted stock awards are recorded as a reduction of shareholders' equity until earned. Compensation expense resulting from these restricted stock awards was \$49 and \$102 for the three and six months ended June 30, 2011, and \$45 and \$122 for the three and six months ended June 30, 2010. As of June 30, 2011, there was \$509 of total unrecognized compensation cost related to unvested restricted stock awards.

A summary of changes in unvested restricted stock awards for the three months ended June 30, 2011 follows:

|                                  | Shares  | Weighted Average<br>Grant Date Fair Value |
|----------------------------------|---------|-------------------------------------------|
| Nonvested at beginning of period | 41,469  | \$ 15.11                                  |
| Granted                          |         |                                           |
| Vested                           |         |                                           |
| Forfeited                        | (1,188) | 14.85                                     |
| Nonvested at end of period       | 40,281  | \$ 15.12                                  |



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A summary of changes in unvested restricted stock awards for the six months ended June 30, 2011 follows:

|                                  | Shares  | Weighted Average<br>Grant Date Fair Value |
|----------------------------------|---------|-------------------------------------------|
| Nonvested at beginning of period | 31,398  | \$ 15.10                                  |
| Granted                          | 17,900  | 14.88                                     |
| Vested                           | (7,829) | 14.55                                     |
| Forfeited                        | (1,188) | 14.85                                     |
| Nonvested at end of period       | 40,281  | \$ 15.12                                  |

**FAIR VALUE****Fair Value Option**

Management elected to adopt the fair value option for its investment in certain equity securities in order to provide financial statement users with greater visibility into the Corporation's financial instruments that do not have a defined maturity date.

Fair value changes attributable to unrealized gains (losses) that were included in earnings for the three and six months ended June 30, 2011 were (\$16) and \$87, respectively. Fair value changes attributable to unrealized losses that were included in earnings for the three and six months ended June 30, 2010 were (\$139) and (\$57). Realized gains on the sale of securities for which the fair value option was elected were \$0 and \$10 during the three and six months ended June 30, 2011. There were no sales of securities for which the fair value option was elected during the three and six months ended June 30, 2010.

Dividend income is recorded based on cash dividends and comprises the Dividends line item in the accompanying consolidated statement of income. Dividend income was \$8 and \$15 for the three and six months ended June 30, 2011 and \$6 and \$14 for the three and six months ended June 30, 2010.

**Fair Value Measurement**

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an 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. A fair value hierarchy has also been established which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following three levels of inputs are used to measure fair value:

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

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

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

The fair values of most trading securities and securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). The fair values of certain residential mortgage-backed securities, one corporate bond, and one bond issued by a government sponsored entity classified as available for sale have been determined by using Level 3 inputs. The Corporation has engaged a valuation expert to price these securities using a proprietary model, which incorporates assumptions that market participants would use in pricing the securities, including bid/ask spreads and liquidity and credit premiums.





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Trust preferred securities which are issued by financial institutions and insurance companies are priced using Level 3 inputs. The decline in the level of observable inputs and market activity in this class of investments by the measurement date has been significant and resulted in unreliable external pricing. Broker pricing and bid/ask spreads, when available, vary widely, and the once active market has become comparatively inactive.

The Corporation engaged a third party consultant who has developed a model for pricing these securities. Information such as historical and current performance of the underlying collateral, deferral and default rates, collateral coverage ratios, break in yield calculations, cash flow projections, liquidity and credit premiums required by a market participant, and financial trend analysis with respect to the individual issuing financial institutions and insurance companies are utilized in determining individual security valuations. Due to the current market conditions as well as the limited trading activity of these securities, the market value of the securities is highly sensitive to assumption changes and market volatility.

The Corporation's derivative instrument is an interest rate swap that trades in liquid markets. As such, significant fair value inputs can generally be verified and do not typically involve significant management judgments (Level 2 inputs).

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Assets and liabilities measured at fair value on a recurring basis are as follows at June 30, 2011 and December 31, 2010:

| Description                                | Total             | Fair Value Measurements at June 30, 2011 Using                             |                                                     |                                                    |
|--------------------------------------------|-------------------|----------------------------------------------------------------------------|-----------------------------------------------------|----------------------------------------------------|
|                                            |                   | Quoted Prices in<br>Active Markets for<br>Identical<br>Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Assets:</b>                             |                   |                                                                            |                                                     |                                                    |
| <b>Securities Available For Sale:</b>      |                   |                                                                            |                                                     |                                                    |
| U.S. Treasury                              | \$ 11,201         | \$                                                                         | \$ 11,201                                           | \$                                                 |
| U.S. Government sponsored entities         | 91,849            |                                                                            | 91,849                                              |                                                    |
| States and political subdivisions          | 121,934           |                                                                            | 121,934                                             |                                                    |
| Residential mortgage and asset backed      | 270,330           |                                                                            | 266,342                                             | 3,988                                              |
| Commercial mortgage and asset backed       | 2,071             |                                                                            | 2,071                                               |                                                    |
| Corporate notes and bonds                  | 12,312            |                                                                            | 10,452                                              | 1,860                                              |
| Pooled trust preferred                     | 1,362             |                                                                            |                                                     | 1,362                                              |
| Pooled SBA                                 | 35,391            | 33,448                                                                     | 1,943                                               |                                                    |
| Other securities                           | 1,714             | 1,714                                                                      |                                                     |                                                    |
| <b>Total Securities Available For Sale</b> | <b>\$ 548,164</b> | <b>\$ 35,162</b>                                                           | <b>\$ 505,792</b>                                   | <b>\$ 7,210</b>                                    |
| <b>Trading Securities:</b>                 |                   |                                                                            |                                                     |                                                    |
| Equity securities financial services       | \$ 541            | \$ 541                                                                     | \$                                                  | \$                                                 |
| International mutual funds                 | 346               | 346                                                                        |                                                     |                                                    |
| Equity securities health care              | 178               | 178                                                                        |                                                     |                                                    |
| U.S. Government sponsored entities         | 176               |                                                                            | 176                                                 |                                                    |
| Large cap growth mutual funds              | 166               | 166                                                                        |                                                     |                                                    |
| Certificates of deposit                    | 156               | 156                                                                        |                                                     |                                                    |
| Money market mutual funds                  | 151               | 151                                                                        |                                                     |                                                    |
| Equity securities energy                   | 128               | 128                                                                        |                                                     |                                                    |
| Real estate investment trust mutual funds  | 127               | 127                                                                        |                                                     |                                                    |
| Large cap value mutual funds               | 113               | 113                                                                        |                                                     |                                                    |
| Equity securities industrials              | 111               | 111                                                                        |                                                     |                                                    |
| Corporate notes and bonds                  | 99                |                                                                            | 99                                                  |                                                    |

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|                                 |                 |                 |               |           |
|---------------------------------|-----------------|-----------------|---------------|-----------|
| Equity securities - utilities   | 64              | 64              |               |           |
| Small cap mutual funds          | 43              | 43              |               |           |
| Mid cap mutual funds            | 42              | 42              |               |           |
| <b>Total Trading Securities</b> | <b>\$ 2,441</b> | <b>\$ 2,166</b> | <b>\$ 275</b> | <b>\$</b> |
| <b>Liabilities,</b>             |                 |                 |               |           |
| Interest rate swaps             | \$ (987)        | \$              | \$ (987)      | \$        |

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| Description                                | Total             | Fair Value Measurements at December 31, 2010 Using                         |                                                     |                                                    |
|--------------------------------------------|-------------------|----------------------------------------------------------------------------|-----------------------------------------------------|----------------------------------------------------|
|                                            |                   | Quoted Prices in<br>Active Markets for<br>Identical<br>Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Assets:</b>                             |                   |                                                                            |                                                     |                                                    |
| <b>Securities Available For Sale:</b>      |                   |                                                                            |                                                     |                                                    |
| U.S. Treasury                              | \$ 8,205          | \$                                                                         | \$ 8,205                                            | \$                                                 |
| U.S. Government sponsored entities         | 105,941           | 2,000                                                                      | 101,941                                             | 2,000                                              |
| States and political subdivisions          | 116,411           | 4,750                                                                      | 111,661                                             |                                                    |
| Residential mortgage and asset backed      | 222,419           | 20,405                                                                     | 199,745                                             | 2,269                                              |
| Corporate notes and bonds                  | 10,751            |                                                                            | 9,511                                               | 1,240                                              |
| Pooled trust preferred                     | 1,292             |                                                                            |                                                     | 1,292                                              |
| Pooled SBA                                 | 33,962            | 28,489                                                                     | 5,473                                               |                                                    |
| Other securities                           | 1,696             | 1,696                                                                      |                                                     |                                                    |
| <b>Total Securities Available For Sale</b> | <b>\$ 500,677</b> | <b>\$ 57,340</b>                                                           | <b>\$ 436,536</b>                                   | <b>\$ 6,801</b>                                    |
| <b>Trading Securities:</b>                 |                   |                                                                            |                                                     |                                                    |
| Equity securities financial services       | \$ 523            | \$ 523                                                                     | \$                                                  | \$                                                 |
| International mutual funds                 | 430               | 430                                                                        |                                                     |                                                    |
| Large cap value mutual funds               | 247               | 247                                                                        |                                                     |                                                    |
| Certificates of deposit                    | 208               | 208                                                                        |                                                     |                                                    |
| Equity securities health care              | 151               | 151                                                                        |                                                     |                                                    |
| U.S. Government sponsored entities         | 147               |                                                                            | 147                                                 |                                                    |
| Large cap growth mutual funds              | 139               | 139                                                                        |                                                     |                                                    |
| Equity securities energy                   | 119               | 119                                                                        |                                                     |                                                    |
| Equity securities industrials              | 98                | 98                                                                         |                                                     |                                                    |
| Corporate notes and bonds                  | 96                |                                                                            | 96                                                  |                                                    |
| Money market mutual funds                  | 75                | 75                                                                         |                                                     |                                                    |
| Equity securities - utilities              | 61                | 61                                                                         |                                                     |                                                    |
| Small cap mutual funds                     | 29                | 29                                                                         |                                                     |                                                    |
| Mid cap mutual funds                       | 28                | 28                                                                         |                                                     |                                                    |
| <b>Total Trading Securities</b>            | <b>\$ 2,351</b>   | <b>\$ 2,108</b>                                                            | <b>\$ 243</b>                                       | <b>\$</b>                                          |
| <b>Liabilities,</b>                        |                   |                                                                            |                                                     |                                                    |
| Interest rate swap                         | \$ (867)          | \$                                                                         | \$ (867)                                            | \$                                                 |

The table below presents a reconciliation and income statement classification of gains and losses for all securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended June 30, 2011:

|                                               | Residential<br>mortgage and<br>asset backed | Corporate<br>notes and<br>bonds | Pooled<br>trust<br>preferred |
|-----------------------------------------------|---------------------------------------------|---------------------------------|------------------------------|
| Balance, April 1, 2011                        | \$ 4,106                                    | \$ 1,895                        | \$ 1,402                     |
| Transfers into Level 3                        |                                             |                                 |                              |
| Transfers out of Level 3                      |                                             |                                 |                              |
| Total gains or losses (realized/unrealized):  |                                             |                                 |                              |
| Included in earnings                          |                                             |                                 |                              |
| Included in other comprehensive income        |                                             | (35)                            | (40)                         |
| Purchases, issuances, sales, and settlements: |                                             |                                 |                              |
| Purchases                                     |                                             |                                 |                              |
| Sales                                         |                                             |                                 |                              |

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Settlements

(118)

|                        |          |          |          |
|------------------------|----------|----------|----------|
| Balance, June 30, 2011 | \$ 3,988 | \$ 1,860 | \$ 1,362 |
|------------------------|----------|----------|----------|

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The table below presents a reconciliation and income statement classification of gains and losses for all securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the six months ended June 30, 2011:

|                                               | Residential mortgage and asset backed | Corporate notes and bonds | U.S. Gov t Sponsored Entities | Pooled trust preferred |
|-----------------------------------------------|---------------------------------------|---------------------------|-------------------------------|------------------------|
| Balance, January 1, 2011                      | \$ 2,269                              | \$ 1,240                  | \$ 2,000                      | \$ 1,292               |
| Transfers into Level 3                        |                                       |                           |                               |                        |
| Transfers out of Level 3 (a)(b)               |                                       |                           | (2,000)                       |                        |
| Total gains or losses (realized/unrealized):  |                                       |                           |                               |                        |
| Included in earnings                          |                                       |                           |                               | (398)                  |
| Included in other comprehensive income        |                                       | 620                       |                               | 468                    |
| Purchases, issuances, sales, and settlements: |                                       |                           |                               |                        |
| Purchases                                     | 1,917                                 |                           |                               |                        |
| Sales                                         |                                       |                           |                               |                        |
| Settlements                                   | (198)                                 |                           |                               |                        |
| Balance, June 30, 2011                        | \$ 3,988                              | \$ 1,860                  | \$                            | \$ 1,362               |

- (a) Transferred from Level 3 to Level 2 since observable market data became available to value the security.
- (b) The Corporation's policy is to recognize transfers in and transfers out as of the actual date of the event or change in circumstances that caused the transfer.

The table below presents a reconciliation and income statement classification of gains and losses for all securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended June 30, 2010:

|                                               | Three months ended<br>June 30, 2010   |                           |                        | Six months ended<br>June 30, 2010     |                           |                        |
|-----------------------------------------------|---------------------------------------|---------------------------|------------------------|---------------------------------------|---------------------------|------------------------|
|                                               | Residential mortgage and asset backed | Corporate notes and bonds | Pooled trust preferred | Residential mortgage and asset backed | Corporate notes and bonds | Pooled trust preferred |
| Beginning balance                             | \$ 460                                | \$ 1,360                  | \$ 1,894               | \$ 503                                | \$                        | \$ 1,909               |
| Transfers into Level 3 (a) (b)                |                                       |                           |                        |                                       | 1,040                     |                        |
| Transfers out of Level 3                      |                                       |                           |                        |                                       |                           |                        |
| Total gains or losses (realized/unrealized):  |                                       |                           |                        |                                       |                           |                        |
| Included in earnings                          |                                       |                           | (318)                  |                                       |                           | (1,102)                |
| Included in other comprehensive income        |                                       | (60)                      | (42)                   |                                       | 260                       | 727                    |
| Purchases, issuances, sales, and settlements: |                                       |                           |                        |                                       |                           |                        |
| Sales                                         |                                       |                           |                        |                                       |                           |                        |
| Settlements                                   | (45)                                  |                           | (10)                   | (88)                                  |                           | (10)                   |
| Ending balance                                | \$ 415                                | \$ 1,300                  | \$ 1,524               | \$ 415                                | \$ 1,300                  | \$ 1,524               |

- (a) Transferred from Level 2 to Level 3 because of lack of observable market data due to decrease in market activity for this security.
- (b) The Corporation's policy is to recognize transfers in and transfers out as of the actual date of the event or change in circumstances that caused the transfer.

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The unrealized losses reported in earnings for the three and six months ended June 30, 2011 and 2010 for Level 3 assets that are still held at the balance sheet date relate to pooled trust preferred securities deemed to be other-than-temporarily impaired.

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During the three months ended June 30, 2011 and 2010, the following available for sale securities reported as Level 1 securities as of the beginning of the period were transferred to the Level 2 category:

|                                       | 2011      | 2010      |
|---------------------------------------|-----------|-----------|
| U.S. Treasury                         | \$ 4,053  | \$        |
| U.S. Government sponsored entities    | 16,124    | 10,038    |
| States and political subdivisions     | 4,929     | 10,248    |
| Residential mortgage and asset backed | 37,659    | 15,910    |
| Commercial mortgage and asset backed  | 2,085     |           |
| Total                                 | \$ 64,850 | \$ 36,196 |

During the six months ended June 30, 2011 and 2010, the following available for sale securities reported as Level 1 securities as of the beginning of the period were transferred to the Level 2 category:

|                                       | 2011      | 2010      |
|---------------------------------------|-----------|-----------|
| U.S. Government sponsored entities    | \$ 2,000  | \$ 24,643 |
| States and political subdivisions     | 4,750     | 3,273     |
| Residential mortgage and asset backed | 20,405    | 5,625     |
| Total                                 | \$ 27,155 | \$ 33,541 |

These securities were transferred from the Level 1 category to the Level 2 category since there were no longer quoted prices for identical assets in active markets that the Corporation had the ability to access.

During the six months ended June 30, 2011, two pooled SBA securities that were classified as Level 2 securities at December 31, 2010 were transferred to the Level 1 category. The fair value on the date of transfer was \$3,437. There were no transfers of securities from the Level 2 category to the Level 1 category during the three months ended June 30, 2011. During the six months ended June 30, 2010, one Pooled SBA security that was classified as a Level 2 security at both December 31, 2009 and March 31, 2010 was transferred to the Level 1 category. The fair value on the date of transfer was \$938. These securities were transferred since the Corporation was able to access a quoted price for identical assets in an active market.

Assets and liabilities measured at fair value on a non-recurring basis are as follows at June 30, 2011 and December 31, 2010:

| Description                              | Total     | Fair Value Measurements at June 30, 2011 Using                                |                                                     |                                                    |
|------------------------------------------|-----------|-------------------------------------------------------------------------------|-----------------------------------------------------|----------------------------------------------------|
|                                          |           | Quoted Prices in<br>Active Markets for<br>Identical<br>Assets<br>(Level<br>1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Assets:                                  |           |                                                                               |                                                     |                                                    |
| Impaired loans:                          |           |                                                                               |                                                     |                                                    |
| Commercial mortgages                     | \$ 14,134 | \$                                                                            | \$                                                  | \$ 14,134                                          |
| Commercial, industrial, and agricultural | 1,299     |                                                                               |                                                     | 1,299                                              |
| Residential real estate                  | 125       |                                                                               |                                                     | 125                                                |

Fair Value Measurements at December 31, 2010 Using



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| <u>Description</u>                       | Total    | Quoted Prices in<br>Active Markets for<br>Identical<br>Assets<br>(Level<br>1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|------------------------------------------|----------|-------------------------------------------------------------------------------|-----------------------------------------------------|----------------------------------------------------|
| <b>Assets:</b>                           |          |                                                                               |                                                     |                                                    |
| <b>Impaired loans:</b>                   |          |                                                                               |                                                     |                                                    |
| Commercial mortgages                     | \$ 9,721 | \$                                                                            | \$                                                  | \$ 9,721                                           |
| Commercial, industrial, and agricultural | 2,474    |                                                                               |                                                     | 2,474                                              |
| Residential real estate                  | 166      |                                                                               |                                                     | 166                                                |

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Impaired loans, which are measured for impairment using the fair value of collateral for collateral dependent loans, had a principal balance of \$16,679 with a valuation allowance of \$1,121 as of June 30, 2011, resulting in an additional provision for loan losses of \$345 and \$263 for the three and six months then ended. Impaired loans had a principal balance of \$13,324 with a valuation allowance of \$963 as of December 31, 2010, resulting in an additional provision for loan losses of \$951 for the year then ended.

**Fair Value of Financial Instruments**

Carrying amount is the estimated fair value for cash and cash equivalents, accrued interest receivable and payable, demand deposits, other borrowings, and variable rate loans, deposits or borrowings 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 loans held for sale is based on market quotes. Fair value of debt is based on current rates for similar financing. It is not practical to determine the fair value of FHLB stock and other equity interests due to restrictions placed on the transferability of these instruments. The fair value of off balance sheet items is based on the current fees or cost that would be charged to enter into or terminate such arrangements. The fair value of off balance sheet items is not material.

While these estimates of fair value are based on management's judgment of the most appropriate factors as of the balance sheet date, there is no assurance that the estimated fair values would have been realized if the assets had been disposed of or the liabilities settled at that date, since market values may differ depending on various circumstances. The estimated fair values would also not apply to subsequent dates.

In addition, other assets and liabilities that are not financial instruments, such as premises and equipment, are not included in the disclosures. Also, non-financial instruments typically not recognized on the balance sheet may have value but are not included in the fair value disclosures. These include, among other items, the estimated earnings power of core deposits, the earnings potential of trust accounts, the trained workforce, customer goodwill, and similar items.

The following table presents the carrying amount and fair value of financial instruments at June 30, 2011 and December 31, 2010:

|                                                    | June 30, 2011   |                | December 31, 2010 |                |
|----------------------------------------------------|-----------------|----------------|-------------------|----------------|
|                                                    | Carrying Amount | Fair Value     | Carrying Amount   | Fair Value     |
| <b>ASSETS</b>                                      |                 |                |                   |                |
| Cash and cash equivalents                          | \$ 43,617       | \$ 43,617      | \$ 37,432         | \$ 37,432      |
| Interest bearing time deposits with other banks    | 1,622           | 1,705          | 2,817             | 2,719          |
| Securities available for sale                      | 548,164         | 548,164        | 500,677           | 500,677        |
| Trading securities                                 | 2,441           | 2,441          | 2,351             | 2,351          |
| Loans held for sale                                | 2,706           | 2,752          | 4,451             | 4,518          |
| Net loans                                          | 810,072         | 831,320        | 783,742           | 807,972        |
| FHLB and other equity interests                    | 6,581           | N/A            | 6,415             | N/A            |
| Accrued interest receivable                        | 5,959           | 5,959          | 5,867             | 5,867          |
| <b>LIABILITIES</b>                                 |                 |                |                   |                |
| Deposits                                           | \$ (1,249,072)  | \$ (1,252,468) | \$ (1,162,868)    | \$ (1,167,071) |
| FHLB, Treasury, tax and loan, and other borrowings | (83,088)        | (87,861)       | (106,507)         | (109,963)      |
| Subordinated debentures                            | (20,620)        | (10,780)       | (20,620)          | (10,660)       |
| Interest rate swaps                                | (987)           | (987)          | (867)             | (867)          |
| Accrued interest payable                           | (1,560)         | (1,560)        | (1,666)           | (1,666)        |

**Table of Contents****SECURITIES**

Securities available for sale at June 30, 2011 and December 31, 2010 were as follows:

|                                     | Amortized<br>Cost | June 30, 2011<br>Unrealized |                   | Fair<br>Value     | Amortized<br>Cost | December 31, 2010<br>Unrealized |                   | Fair<br>Value     |
|-------------------------------------|-------------------|-----------------------------|-------------------|-------------------|-------------------|---------------------------------|-------------------|-------------------|
|                                     |                   | Gains                       | Losses            |                   |                   | Gains                           | Losses            |                   |
| U.S. Treasury                       | \$ 11,113         | \$ 88                       | \$                | \$ 11,201         | \$ 8,139          | \$ 66                           | \$                | \$ 8,205          |
| U.S. Gov t sponsored entities       | 88,953            | 2,950                       | (54)              | 91,849            | 104,328           | 2,016                           | (403)             | 105,941           |
| State & political subdivisions      | 118,912           | 3,324                       | (302)             | 121,934           | 117,928           | 1,011                           | (2,528)           | 116,411           |
| Residential mortgage & asset backed | 264,114           | 6,403                       | (187)             | 270,330           | 221,304           | 2,364                           | (1,249)           | 222,419           |
| Commercial mortgage & asset backed  | 2,082             |                             | (11)              | 2,071             |                   |                                 |                   |                   |
| Corporate notes & bonds             | 14,348            |                             | (2,036)           | 12,312            | 14,347            |                                 | (3,596)           | 10,751            |
| Pooled trust preferred              | 1,792             |                             | (430)             | 1,362             | 2,190             | 12                              | (910)             | 1,292             |
| Pooled SBA                          | 34,763            | 665                         | (37)              | 35,391            | 33,788            | 266                             | (92)              | 33,962            |
| Other securities                    | 1,670             | 44                          |                   | 1,714             | 1,670             | 26                              |                   | 1,696             |
| <b>Total</b>                        | <b>\$ 537,747</b> | <b>\$ 13,474</b>            | <b>\$ (3,057)</b> | <b>\$ 548,164</b> | <b>\$ 503,694</b> | <b>\$ 5,761</b>                 | <b>\$ (8,778)</b> | <b>\$ 500,677</b> |

At June 30, 2011, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

Trading securities accounted for under the fair value option at June 30, 2011 and December 31, 2010 are as follows:

|                                           | June 30,<br>2011 | December 31,<br>2010 |
|-------------------------------------------|------------------|----------------------|
| Corporate equity securities               | \$ 1,022         | \$ 952               |
| International mutual funds                | 346              | 430                  |
| U.S. Government sponsored entities        | 176              | 147                  |
| Large cap growth mutual funds             | 166              | 139                  |
| Certificates of deposit                   | 156              | 208                  |
| Money market mutual funds                 | 151              | 75                   |
| Real estate investment trust mutual funds | 127              |                      |
| Large cap value mutual funds              | 113              | 247                  |
| Corporate notes and bonds                 | 99               | 96                   |
| Small cap mutual funds                    | 43               | 29                   |
| Mid cap mutual funds                      | 42               | 28                   |
| <b>Total</b>                              | <b>\$ 2,441</b>  | <b>\$ 2,351</b>      |

Securities with unrealized losses at June 30, 2011 and December 31, 2010, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows (in thousands):

| Description of Securities      | June 30, 2011 |                 | December 31, 2010 |                 | Total      |                 |
|--------------------------------|---------------|-----------------|-------------------|-----------------|------------|-----------------|
|                                | Fair Value    | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. Treasury                  | \$            | \$              | \$                | \$              | \$         | \$              |
| U.S. Gov t sponsored entities  | 5,769         | (54)            |                   |                 | 5,769      | (54)            |
| State & political subdivisions | 17,749        | (292)           | 1,554             | (10)            | 19,303     | (302)           |

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|                                     |           |          |           |            |           |            |
|-------------------------------------|-----------|----------|-----------|------------|-----------|------------|
| Residential mortgage & asset backed | 30,548    | (172)    | 2,689     | (15)       | 33,237    | (187)      |
| Commercial mortgage & asset backed  | 2,071     | (11)     |           |            | 2,071     | (11)       |
| Corporate notes & bonds             |           |          | 12,312    | (2,036)    | 12,312    | (2,036)    |
| Pooled trust preferred              | 982       | (10)     | 380       | (420)      | 1,362     | (430)      |
| Pooled SBA                          | 9,290     | (37)     |           |            | 9,290     | (37)       |
| Other securities                    |           |          |           |            |           |            |
|                                     | \$ 66,409 | \$ (576) | \$ 16,935 | \$ (2,481) | \$ 83,344 | \$ (3,057) |

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|                                     | Less than 12 Months |                 | 12 Months or More |                 | Total      |                 |
|-------------------------------------|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
|                                     | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| <b>December 31, 2010</b>            |                     |                 |                   |                 |            |                 |
| U.S. Treasury                       | \$                  | \$              | \$                | \$              | \$         | \$              |
| U.S. Gov t sponsored entities       | 11,077              | (403)           |                   |                 | 11,077     | (403)           |
| State & political subdivisions      | 61,312              | (2,440)         | 3,904             | (88)            | 65,216     | (2,528)         |
| Residential mortgage & asset backed | 69,576              | (1,228)         | 5,770             | (21)            | 75,346     | (1,249)         |
| Corporate notes & bonds             | 992                 | (3)             | 9,770             | (3,593)         | 10,762     | (3,596)         |
| Pooled trust preferred              |                     |                 | 288               | (910)           | 288        | (910)           |
| Pooled SBA                          | 12,147              | (92)            |                   |                 | 12,147     | (92)            |
| Other securities                    |                     |                 |                   |                 |            |                 |
|                                     | \$ 155,104          | \$ (4,166)      | \$ 19,732         | \$ (4,612)      | \$ 174,836 | \$ (8,778)      |

The Corporation evaluates securities for other-than-temporary impairment on a quarterly basis, or more frequently when economic or market conditions warrant such an evaluation.

At June 30, 2011, management evaluated the structured pooled trust preferred securities for other-than-temporary impairment by estimating the cash flows expected to be received from each security within the collateral pool, taking into account future estimated levels of deferrals and defaults by the underlying issuers, and discounting those cash flows at the appropriate accounting yield. Management also assumed that all issuers in deferral will default prior to their next payment date. Trust preferred collateral is deeply subordinated within issuers' capital structures, so large recoveries are unlikely. Accordingly, management assumed 10% recoveries on bank collateral and none on collateral issued by other companies. Due to the current crisis in the U.S. economy, management also added a baseline default rate of 2% annually for the next two years to our default projections for specific issuers. This percentage represents the peak, post-war bank default rate that occurred at the height of the savings and loan crisis, which we believe is an accurate proxy for the current environment. Management expects that credit markets will begin to normalize and that banks with the financial strength to survive will default at a .36% average annual rate, which represents Moody's idealized default probability for BBB corporate credits, and is in line with historical bank failure rates. In addition, management expects prepayments to occur at a rate of approximately 5% over a five year period, with the exception of certain large institutions that are expected to begin calling their collateral in 2011 and 2012 as a result of the elimination of the Tier I capital treatment of trust preferred securities for institutions with greater than \$15 billion in assets beginning in 2013.

Using this methodology, five of the Corporation's structured pooled trust preferred securities are deemed to be other-than-temporarily impaired. An impairment loss for the entire cost basis of two of these securities was recognized in earnings prior to 2010, and impairment losses for the remaining securities were recognized in earnings during 2011 as disclosed in the table below. The Corporation separated the other-than-temporary impairment related to these structured pooled trust preferred securities into (a) the amount of the total impairment related to credit loss, which is recognized in the income statement, and (b) the amount of the total impairment related to all other factors, which is recognized in other comprehensive income. The Corporation measured the credit loss component of other-than-temporary impairment based on the difference between the cost basis and the present value of cash flows expected to be collected.

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The following table provides detailed information related to the Corporation's structured pooled trust preferred securities as of and for the three months ended June 30, 2011:

|                                     | Adjusted<br>Amortized<br>Cost | Unrealized<br>Gain (Loss) | Fair<br>Value   | Credit Losses<br>Realized in Earnings<br>Three Months<br>Ended June 30, 2011 | Credit Losses<br>Realized in Earnings<br>Six Months<br>Ended June 30, 2011 |
|-------------------------------------|-------------------------------|---------------------------|-----------------|------------------------------------------------------------------------------|----------------------------------------------------------------------------|
| ALESCO Preferred Funding V, Ltd.    | \$ 800                        | \$ (420)                  | \$ 380          | \$                                                                           | \$                                                                         |
| ALESCO Preferred Funding XII, Ltd.  |                               |                           |                 |                                                                              | 280                                                                        |
| ALESCO Preferred Funding XVII, Ltd. |                               |                           |                 |                                                                              |                                                                            |
| Preferred Term Securities XVI, Ltd. |                               |                           |                 |                                                                              | 118                                                                        |
| US Capital Funding VI, Ltd.         |                               |                           |                 |                                                                              |                                                                            |
| MM Community Funding II, Ltd.       | 992                           | (10)                      | 982             |                                                                              |                                                                            |
| <b>Total</b>                        | <b>\$ 1,792</b>               | <b>\$ (430)</b>           | <b>\$ 1,362</b> | <b>\$</b>                                                                    | <b>\$ 398</b>                                                              |

A roll-forward of the other-than-temporary impairment amount related to credit losses for the three months ended June 30, 2011 is as follows:

|                                                                                                                                                                      |          |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in other comprehensive income, beginning of period | \$ 4,054 |
| Additional credit loss for which other-than-temporary impairment was not previously recognized                                                                       |          |
| Additional credit loss for which other-than-temporary impairment was previously recognized                                                                           |          |

|                                                                                                                                                                |          |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in other comprehensive income, end of period | \$ 4,054 |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|

A roll-forward of the other-than-temporary impairment amount related to credit losses for the six months ended June 30, 2011 is as follows:

|                                                                                                                                                                      |          |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in other comprehensive income, beginning of period | \$ 3,656 |
| Additional credit loss for which other-than-temporary impairment was not previously recognized                                                                       |          |
| Additional credit loss for which other-than-temporary impairment was previously recognized                                                                           | 398      |

|                                                                                                                                                                |          |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in other comprehensive income, end of period | \$ 4,054 |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|

A roll-forward of the other-than-temporary impairment amount related to credit losses for the three months ended June 30, 2010 is as follows:

|                                                                                                                                                                      |          |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in other comprehensive income, beginning of period | \$ 2,199 |
| Additional credit loss for which other-than-temporary impairment was not previously recognized                                                                       | 318      |

|                                                                                                                                                                |          |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in other comprehensive income, end of period | \$ 2,517 |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|



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A roll-forward of the other-than-temporary impairment amount related to credit losses for the six months ended June 30, 2010 is as follows:

|                                                                                                                                                                      |          |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in other comprehensive income, beginning of period | \$ 1,415 |
| Additional credit loss for which other-than-temporary impairment was not previously recognized                                                                       | 1,102    |
| Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in other comprehensive income, end of period       | \$ 2,517 |

At June 30, 2011, approximately 14% of the total unrealized losses relate to structured pooled trust preferred securities, primarily from issuers in the financial services industry, which are not currently trading in an active, open market with readily observable prices. As a result, these securities were classified within Level 3 of the valuation hierarchy. The fair values of these securities have been calculated using a discounted cash flow model and market liquidity premium. With the current market conditions, the assumptions used to determine the fair value of Level 3 securities has greater subjectivity due to the lack of observable market transactions. The fair values of these securities have declined due to the fact that subsequent offerings of similar securities pay a higher market rate of return. This higher rate of return reflects the increased credit and liquidity risks in the marketplace. Except as described above, based on management's evaluation of the structured pooled trust preferred securities, the present value of the projected cash flows is sufficient for full repayment of the amortized cost of the securities and, therefore, it is believed that the decline in fair value is temporary due to current market conditions. However, without recovery of these securities, other-than-temporary impairments may occur in future periods.

For all of the securities that comprise corporate notes and bonds and states and political subdivisions, management monitors publicly available financial information such as filings with the Securities and Exchange Commission in order to evaluate the securities for other-than-temporary impairment. For financial institution issuers, management also monitors information from quarterly call report filings that are used to generate Uniform Bank Performance Reports. When reviewing this information, management considers the financial condition and near term prospects of the issuer and whether downgrades by bond rating agencies have occurred. Management also considers the length of time and extent to which fair value has been less than cost and the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

As of June 30, 2011 and December 31, 2010, management concluded that the previously mentioned securities were not other-than-temporarily impaired for the following reasons:

There is no indication of any significant deterioration of the creditworthiness of the institutions that issued the securities.

The unrealized losses are predominantly attributable to liquidity disruptions within the credit markets and the generally stressed condition of the financial services industry.

All contractual interest payments on the securities have been received as scheduled, and no information has come to management's attention through the processes previously described which would lead to a conclusion that future contractual payments will not be received timely.

The Corporation does not intend to sell and it is not more likely than not that it will be required to sell the securities in an unrealized loss position before recovery of its amortized cost basis.

Information pertaining to security sales is as follows:

|                                  | Proceeds | Gross Gains | Gross Losses |
|----------------------------------|----------|-------------|--------------|
| Three months ended June 30, 2011 | \$       | \$          | \$           |



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|                                  |        |     |      |
|----------------------------------|--------|-----|------|
| Six months ended June 30, 2011   | 23,610 | 146 | (72) |
| Three months ended June 30, 2010 | 11,095 | 141 | (-)  |
| Six months ended June 30, 2010   | 38,065 | 587 | (14) |

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The following is a schedule of the contractual maturity of securities available for sale, excluding equity securities, at June 30, 2011 and December 31, 2010:

|                                                | June 30, 2011  |            | December 31, 2010 |            |
|------------------------------------------------|----------------|------------|-------------------|------------|
|                                                | Amortized Cost | Fair Value | Amortized Cost    | Fair Value |
| 1 year or less                                 | \$ 18,580      | \$ 18,665  | \$ 30,210         | \$ 30,184  |
| 1 year 5 years                                 | 61,681         | 63,109     | 54,476            | 55,030     |
| 5 years 10 years                               | 96,905         | 100,146    | 105,057           | 105,145    |
| After 10 years                                 | 92,715         | 92,129     | 90,977            | 86,203     |
|                                                | 269,881        | 274,049    | 280,720           | 276,562    |
| Residential mortgage & asset backed securities | 264,114        | 270,330    | 221,304           | 222,419    |
| Commercial mortgage & asset backed securities  | 2,082          | 2,071      |                   |            |
| Total debt securities                          | \$ 536,077     | \$ 546,450 | \$ 502,024        | \$ 498,981 |

Mortgage and asset backed securities are not due at a single date; periodic payments are received based on the payment patterns of the underlying collateral.

On June 30, 2011 and December 31, 2010, securities carried at \$170,202 and \$127,364, respectively, were pledged to secure public deposits and for other purposes as provided by law.

**LOANS**

Total net loans at June 30, 2011 and December 31, 2010 are summarized as follows:

|                                                   | June 30, 2011 | December 31, 2010 |
|---------------------------------------------------|---------------|-------------------|
| Commercial, industrial, and agricultural          | \$ 251,530    | \$ 257,491        |
| Commercial mortgages                              | 235,409       | 212,878           |
| Residential real estate                           | 280,029       | 266,604           |
| Consumer                                          | 53,894        | 53,202            |
| Credit cards                                      | 2,976         | 2,870             |
| Overdrafts                                        | 617           | 3,964             |
| Less: unearned discount allowance for loan losses | (2,668)       | (2,447)           |
|                                                   | (11,715)      | (10,820)          |
| Loans, net                                        | \$ 810,072    | \$ 783,742        |

At June 30, 2011 and December 31, 2010, net unamortized loan costs and fees of (\$89) and (\$167), respectively, have been included in the carrying value of loans.

The Corporation's outstanding loans and related unfunded commitments are primarily concentrated within Central and Western Pennsylvania. The Bank attempts to limit concentrations within specific industries by utilizing dollar limitations to single industries or customers, and by entering into participation agreements with third parties. Collateral requirements are established based on management's assessment of the customer.

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Transactions in the allowance for loan losses for the three months ended June 30, 2011 were as follows:

|                                          | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total     |
|------------------------------------------|------------------------------------------------|-------------------------|-------------------------------|----------|-----------------|------------|-----------|
| Allowance for loan losses, April 1, 2011 | \$ 3,732                                       | \$ 3,879                | \$ 1,879                      | \$ 1,507 | \$ 96           | \$ 131     | \$ 11,224 |
| Charge-offs                              | (173)                                          | (41)                    | (63)                          | (202)    | (7)             | (62)       | (548)     |
| Recoveries                               | 3                                              |                         |                               | 21       | 3               | 20         | 47        |
| Provision (benefit) for loan losses      | 208                                            | 561                     | 84                            | 74       | 12              | 53         | 992       |
| Allowance for loan losses, June 30, 2011 | \$ 3,770                                       | \$ 4,399                | \$ 1,900                      | \$ 1,400 | \$ 104          | \$ 142     | \$ 11,715 |

Transactions in the allowance for loan losses for the six months ended June 30, 2011 were as follows:

|                                            | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total     |
|--------------------------------------------|------------------------------------------------|-------------------------|-------------------------------|----------|-----------------|------------|-----------|
| Allowance for loan losses, January 1, 2011 | \$ 3,517                                       | \$ 3,511                | \$ 1,916                      | \$ 1,561 | \$ 96           | \$ 219     | \$ 10,820 |
| Charge-offs                                | (215)                                          | (88)                    | (77)                          | (462)    | (25)            | (115)      | (982)     |
| Recoveries                                 | 4                                              |                         |                               | 45       | 5               | 54         | 108       |
| Provision (benefit) for loan losses        | 464                                            | 976                     | 61                            | 256      | 28              | (16)       | 1,769     |
| Allowance for loan losses, June 30, 2011   | \$ 3,770                                       | \$ 4,399                | \$ 1,900                      | \$ 1,400 | \$ 104          | \$ 142     | \$ 11,715 |

Transactions in the allowance for loan losses for the three months ended June 30, 2010 were as follows:

|                                          |           |
|------------------------------------------|-----------|
| Allowance for loan losses, April 1, 2010 | \$ 9,914  |
| Charge-off                               | (715)     |
| Recoveries                               | 55        |
| Provision for loan losses                | 1,161     |
| Allowance for loan losses, June 30, 2010 | \$ 10,415 |

Transactions in the allowance for loan losses for the six months ended June 30, 2010 were as follows:

|                                            |           |
|--------------------------------------------|-----------|
| Allowance for loan losses, January 1, 2010 | \$ 9,795  |
| Charge-off                                 | (1,256)   |
| Recoveries                                 | 130       |
| Provision for loan losses                  | 1,746     |
| Allowance for loan losses, June 30, 2010   | \$ 10,415 |

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and is based on the Corporation's impairment method as of June 30, 2011:

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|                                                 | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer         | Credit<br>Cards | Overdrafts    | Total             |
|-------------------------------------------------|------------------------------------------------|-------------------------|-------------------------------|------------------|-----------------|---------------|-------------------|
| Allowance for loan losses:                      |                                                |                         |                               |                  |                 |               |                   |
| Ending allowance balance attributable to loans: |                                                |                         |                               |                  |                 |               |                   |
| Individually evaluated for impairment           | \$ 130                                         | \$ 698                  | \$ 59                         | \$               | \$              | \$            | \$ 887            |
| Collectively evaluated for impairment           | 3,640                                          | 3,467                   | 1,841                         | 1,400            | 104             | 142           | 10,594            |
| Modified in a troubled debt restructuring       |                                                | 234                     |                               |                  |                 |               | 234               |
| Acquired with deteriorated credit quality       |                                                |                         |                               |                  |                 |               |                   |
| <b>Total ending allowance balance</b>           | <b>\$ 3,770</b>                                | <b>\$ 4,399</b>         | <b>\$ 1,900</b>               | <b>\$ 1,400</b>  | <b>\$ 104</b>   | <b>\$ 142</b> | <b>\$ 11,715</b>  |
| Loans:                                          |                                                |                         |                               |                  |                 |               |                   |
| Loans individually evaluated for impairment     | \$ 1,429                                       | \$ 15,066               | \$ 184                        | \$               | \$              | \$            | \$ 16,679         |
| Loans collectively evaluated for impairment     | 250,101                                        | 215,592                 | 279,845                       | 53,894           | 2,976           | 617           | 803,025           |
| Loans modified in a troubled debt restructuring |                                                | 4,751                   |                               |                  |                 |               | 4,751             |
| Loans acquired with deteriorated credit quality |                                                |                         |                               |                  |                 |               |                   |
| <b>Total ending loans balance</b>               | <b>\$ 251,530</b>                              | <b>\$ 235,409</b>       | <b>\$ 280,029</b>             | <b>\$ 53,894</b> | <b>\$ 2,976</b> | <b>\$ 617</b> | <b>\$ 824,455</b> |

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The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and is based on the Corporation's impairment method as of December 31, 2010:

|                                                        | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer         | Credit<br>Cards | Overdrafts      | Total             |
|--------------------------------------------------------|------------------------------------------------|-------------------------|-------------------------------|------------------|-----------------|-----------------|-------------------|
| <b>Allowance for loan losses:</b>                      |                                                |                         |                               |                  |                 |                 |                   |
| <b>Ending allowance balance attributable to loans:</b> |                                                |                         |                               |                  |                 |                 |                   |
| Individually evaluated for impairment                  | \$ 142                                         | \$ 509                  | \$ 69                         | \$               | \$              | \$              | \$ 720            |
| Collectively evaluated for impairment                  | 3,375                                          | 2,759                   | 1,847                         | 1,561            | 96              | 219             | 9,857             |
| Modified in a troubled debt restructuring              |                                                | 243                     |                               |                  |                 |                 | 243               |
| Acquired with deteriorated credit quality              |                                                |                         |                               |                  |                 |                 |                   |
| <b>Total ending allowance balance</b>                  | <b>\$ 3,517</b>                                | <b>\$ 3,511</b>         | <b>\$ 1,916</b>               | <b>\$ 1,561</b>  | <b>\$ 96</b>    | <b>\$ 219</b>   | <b>\$ 10,820</b>  |
| <b>Loans:</b>                                          |                                                |                         |                               |                  |                 |                 |                   |
| Loans individually evaluated for impairment            | \$ 2,616                                       | \$ 8,759                | \$ 235                        | \$               | \$              | \$              | \$ 11,610         |
| Loans collectively evaluated for impairment            | 254,875                                        | 202,405                 | 266,369                       | 53,202           | 2,870           | 3,964           | 783,685           |
| Loans modified in a troubled debt restructuring        |                                                | 1,714                   |                               |                  |                 |                 | 1,714             |
| Loans acquired with deteriorated credit quality        |                                                |                         |                               |                  |                 |                 |                   |
| <b>Total ending loans balance</b>                      | <b>\$ 257,491</b>                              | <b>\$ 212,878</b>       | <b>\$ 266,604</b>             | <b>\$ 53,202</b> | <b>\$ 2,870</b> | <b>\$ 3,964</b> | <b>\$ 797,009</b> |

The following tables present information related to loans individually evaluated for impairment by portfolio segment as of and for the three and six months ended June 30, 2011:

|                                            | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Allowance for<br>Loan Losses<br>Allocated |
|--------------------------------------------|--------------------------------|------------------------|-------------------------------------------|
| <b>With an allowance recorded:</b>         |                                |                        |                                           |
| Commercial, industrial, and agricultural   | \$ 600                         | \$ 509                 | \$ 130                                    |
| Commercial mortgage                        | 8,185                          | 7,336                  | 932                                       |
| Residential real estate                    | 267                            | 184                    | 59                                        |
| <b>With no related allowance recorded:</b> |                                |                        |                                           |
| Commercial, industrial, and agricultural   | 1,390                          | 920                    |                                           |
| Commercial mortgage                        | 9,490                          | 7,730                  |                                           |
| Residential real estate                    |                                |                        |                                           |
| <b>Total</b>                               | <b>\$ 19,932</b>               | <b>\$ 16,679</b>       | <b>\$ 1,121</b>                           |

|                                            | Three Months Ended June 30, 2011  |                                  |                                         | Six Months Ended June 30, 2011    |                                  |                                         |
|--------------------------------------------|-----------------------------------|----------------------------------|-----------------------------------------|-----------------------------------|----------------------------------|-----------------------------------------|
|                                            | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Cash<br>Basis<br>Interest<br>Recognized | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Cash<br>Basis<br>Interest<br>Recognized |
| <b>With an allowance recorded:</b>         |                                   |                                  |                                         |                                   |                                  |                                         |
| Commercial, industrial, and agricultural   | \$ 1,183                          | \$                               | \$                                      | \$ 1,660                          | \$                               | \$                                      |
| Commercial mortgage                        | 8,835                             | 14                               | 14                                      | 8,810                             | 16                               | 16                                      |
| Residential real estate                    | 185                               |                                  |                                         | 202                               |                                  |                                         |
| <b>With no related allowance recorded:</b> |                                   |                                  |                                         |                                   |                                  |                                         |

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|                                          |           |       |       |           |       |       |  |
|------------------------------------------|-----------|-------|-------|-----------|-------|-------|--|
| Commercial, industrial, and agricultural | 2,411     |       |       | 1,607     |       |       |  |
| Commercial mortgage                      | 4,584     |       |       | 3,506     |       |       |  |
| Residential real estate                  |           |       |       |           |       |       |  |
| Total                                    | \$ 17,198 | \$ 14 | \$ 14 | \$ 15,785 | \$ 16 | \$ 16 |  |

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The following table presents information related to loans individually evaluated for impairment by portfolio segment as of December 31, 2010:

|                                            | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Allowance for<br>Loan Losses<br>Allocated |
|--------------------------------------------|--------------------------------|------------------------|-------------------------------------------|
| <b>With an allowance recorded:</b>         |                                |                        |                                           |
| Commercial, industrial, and agricultural   | \$ 3,041                       | \$ 2,616               | \$ 142                                    |
| Commercial mortgage                        | 13,070                         | 10,473                 | 752                                       |
| Residential real estate                    | 339                            | 235                    | 69                                        |
| <b>With no related allowance recorded:</b> |                                |                        |                                           |
| Commercial, industrial, and agricultural   |                                |                        |                                           |
| Commercial mortgage                        |                                |                        |                                           |
| Residential real estate                    |                                |                        |                                           |
| <b>Total</b>                               | <b>\$ 16,450</b>               | <b>\$ 13,324</b>       | <b>\$ 963</b>                             |

The unpaid principal balance of impaired loans includes the Corporation's recorded investment in the loan and amounts that have been charged off.

The following table presents information for loans individually evaluated for impairment during the three months ended June 30, 2010:

|                                                         |           |
|---------------------------------------------------------|-----------|
| Average of individually impaired loans during period    | \$ 14,718 |
| Interest income recognized during impairment            | 241       |
| Cash basis interest income recognized during impairment | 241       |

The following table presents information for loans individually evaluated for impairment during the six months ended June 30, 2010:

|                                                         |           |
|---------------------------------------------------------|-----------|
| Average of individually impaired loans during period    | \$ 15,046 |
| Interest income recognized during impairment            | 340       |
| Cash basis interest income recognized during impairment | 340       |

The following tables present the recorded investment in nonaccrual loans and loans past due over 90 days still on accrual by portfolio segment as of June 30, 2011 and December 31, 2010:

|                                          | Nonaccrual       | Past Due Over 90 Days<br>Still on Accrual |
|------------------------------------------|------------------|-------------------------------------------|
| <b>June 30, 2011</b>                     |                  |                                           |
| Commercial, industrial, and agricultural | \$ 7,195         | \$ 1,499                                  |
| Commercial mortgages                     | 7,539            | 125                                       |
| Residential real estate                  | 1,339            | 135                                       |
| Consumer                                 | 25               | 116                                       |
| Credit cards                             |                  | 34                                        |
| <b>Total</b>                             | <b>\$ 16,098</b> | <b>\$ 1,909</b>                           |

Nonaccrual

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|                                          |                  | Past Due Over 90 Days |
|------------------------------------------|------------------|-----------------------|
|                                          |                  | Still on Accrual      |
| <b>December 31, 2010</b>                 |                  |                       |
| Commercial, industrial, and agricultural | \$ 2,344         | \$ 23                 |
| Commercial mortgages                     | 8,276            | 321                   |
| Residential real estate                  | 1,306            | 386                   |
| Consumer                                 |                  | 154                   |
| Credit cards                             |                  | 5                     |
| <b>Total</b>                             | <b>\$ 11,926</b> | <b>\$ 889</b>         |



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Nonaccrual loans and loans past due over 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following tables present the aging of the recorded investment in past due loans as of June 30, 2011 and December 31, 2010 by class of loans:

| <b>June 30, 2011</b>                     | 30-59 Days      | 60-89 Days      | Greater Than        | Total Past       | Loans Not         | Total             |
|------------------------------------------|-----------------|-----------------|---------------------|------------------|-------------------|-------------------|
|                                          | Past Due        | Past Due        | 90 Days<br>Past Due |                  |                   |                   |
| Commercial, industrial, and agricultural | \$ 111          | \$ 344          | \$ 8,694            | \$ 9,149         | \$ 242,381        | \$ 251,530        |
| Commercial mortgages                     | 2,527           | 1,927           | 7,664               | 12,118           | 223,291           | 235,409           |
| Residential real estate                  | 1,249           | 342             | 1,474               | 3,065            | 276,964           | 280,029           |
| Consumer                                 | 420             | 212             | 141                 | 773              | 53,121            | 53,894            |
| Credit cards                             | 13              | 15              | 34                  | 62               | 2,914             | 2,976             |
| Overdrafts                               |                 |                 |                     |                  | 617               | 617               |
| <b>Total</b>                             | <b>\$ 4,320</b> | <b>\$ 2,840</b> | <b>\$ 18,007</b>    | <b>\$ 25,167</b> | <b>\$ 799,288</b> | <b>\$ 824,455</b> |

| <b>December 31, 2010</b>                 | 30-59 Days      | 60-89 Days      | Greater Than        | Total Past       | Loans Not         | Total             |
|------------------------------------------|-----------------|-----------------|---------------------|------------------|-------------------|-------------------|
|                                          | Past Due        | Past Due        | 90 Days<br>Past Due |                  |                   |                   |
| Commercial, industrial, and agricultural | \$ 225          | \$ 2,512        | \$ 2,367            | \$ 5,104         | \$ 252,387        | \$ 257,491        |
| Commercial mortgages                     | 129             | 1,184           | 8,597               | 9,910            | 202,968           | 212,878           |
| Residential real estate                  | 1,629           | 262             | 1,692               | 3,583            | 263,021           | 266,604           |
| Consumer                                 | 455             | 145             | 154                 | 754              | 52,448            | 53,202            |
| Credit cards                             | 20              | 10              | 5                   | 35               | 2,835             | 2,870             |
| Overdrafts                               |                 |                 |                     |                  | 3,964             | 3,964             |
| <b>Total</b>                             | <b>\$ 2,458</b> | <b>\$ 4,113</b> | <b>\$ 12,815</b>    | <b>\$ 19,386</b> | <b>\$ 777,623</b> | <b>\$ 797,009</b> |

**Troubled Debt Restructurings**

The Corporation has allocated \$234 and \$243 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of June 30, 2011 and December 31, 2010, respectively. The Corporation has no further loan commitments to customers whose loans are classified as a troubled debt restructuring.

**Credit Quality Indicators**

The Corporation classifies commercial, industrial, and agricultural loans and commercial mortgage loans into risk categories based on relevant information about the ability of borrowers to service their debt, such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Corporation analyzes loans individually by classifying the loans as to credit risk. This analysis includes loans with an outstanding balance greater than \$1 million bi-annually and loans with an outstanding balance of less than \$1 million at least annually.

The Corporation uses the following definitions for risk ratings:

**Special Mention:** Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Corporation's credit position at some future date.

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Substandard: Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected.

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Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not rated as special mention, substandard, or doubtful are considered to be pass rated loans. All loans included in the following tables have been assigned a risk rating within 12 months of the balance sheet date.

| June 30, 2011                            | Pass              | Special          | Substandard      | Doubtful      | Total             |
|------------------------------------------|-------------------|------------------|------------------|---------------|-------------------|
|                                          |                   | Mention          |                  |               |                   |
| Commercial, industrial, and agricultural | \$ 217,377        | \$ 15,147        | \$ 19,006        | \$            | \$ 251,530        |
| Commercial mortgages                     | 213,103           | 4,635            | 17,550           | 121           | 235,409           |
| <b>Total</b>                             | <b>\$ 430,480</b> | <b>\$ 19,782</b> | <b>\$ 36,556</b> | <b>\$ 121</b> | <b>\$ 486,939</b> |

| December 31, 2010                        | Pass              | Special          | Substandard      | Doubtful      | Total             |
|------------------------------------------|-------------------|------------------|------------------|---------------|-------------------|
|                                          |                   | Mention          |                  |               |                   |
| Commercial, industrial, and agricultural | \$ 223,196        | \$ 4,830         | \$ 29,450        | \$ 15         | \$ 257,491        |
| Commercial mortgages                     | 188,846           | 7,673            | 16,249           | 110           | 212,878           |
| <b>Total</b>                             | <b>\$ 412,042</b> | <b>\$ 12,503</b> | <b>\$ 45,699</b> | <b>\$ 125</b> | <b>\$ 470,369</b> |

The Corporation's portfolio of residential real estate and consumer loans maintained within Holiday Financial Services Corporation ( Holiday ), our subsidiary that offers small balance unsecured loans, primarily collateralized by automobiles and equipment, to borrowers with higher risk characteristics, are considered to be subprime loans. Holiday originates small balance unsecured loans and secured loans, primarily collateralized by automobiles and equipment, to borrowers with higher credit risk characteristics than are typical in the consumer loan portfolio held by the Bank. Holiday's loan portfolio is summarized as follows at June 30, 2011 and December 31, 2010:

|                         | June 30,<br>2011 | December 31,<br>2010 |
|-------------------------|------------------|----------------------|
| Consumer                | \$ 17,040        | \$ 16,532            |
| Residential real estate | 1,059            | 1,149                |
| Less: unearned discount | (2,668)          | (2,447)              |
| <b>Total</b>            | <b>\$ 15,431</b> | <b>\$ 15,234</b>     |

The Corporation considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential real estate and consumer loan classes, the Corporation also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in residential and consumer loans based on payment activity as of June 30, 2011 and December 31, 2010:

|                | June 30, 2011              |                  | December 31, 2010          |                  |
|----------------|----------------------------|------------------|----------------------------|------------------|
|                | Residential<br>Real Estate | Consumer         | Residential<br>Real Estate | Consumer         |
| Performing     | \$ 278,555                 | \$ 53,753        | \$ 264,912                 | \$ 53,048        |
| Non-performing | 1,474                      | 141              | 1,692                      | 154              |
| <b>Total</b>   | <b>\$ 280,029</b>          | <b>\$ 53,894</b> | <b>\$ 266,604</b>          | <b>\$ 53,202</b> |



**Table of Contents****FEDERAL HOME LOAN BANK (FHLB) STOCK**

As a member of the Federal Home Loan Bank of Pittsburgh ( FHLB ), the Corporation is required to purchase and hold stock in the FHLB to satisfy membership and borrowing requirements. This stock is restricted in that it can only be sold to the FHLB or to another member institution, and all sales of FHLB stock must be at par. As a result of these restrictions, FHLB stock is unlike other investment securities insofar as there is no trading market for FHLB stock and the transfer price is determined by FHLB membership rules and not by market participants.

As of June 30, 2011, the Corporation holds \$5,418 of stock in FHLB. In December 2008, the FHLB voluntarily suspended dividend payments on its stock, as well as the repurchase of excess stock from members. The FHLB cited a significant reduction in the level of core earnings resulting from lower short-term interest rates, the increased cost of liquidity, and constrained access to the debt markets at attractive rates and maturities as the main reasons for the decision to suspend dividends and the repurchase of excess capital stock. The FHLB last paid a dividend in the third quarter of 2008.

FHLB stock is held as a long-term investment and its value is determined based on the ultimate recoverability of the par value. The Company evaluates impairment quarterly. The decision of whether impairment exists is a matter of judgment that reflects our view of the FHLB's long-term performance, which includes factors such as the following:

its operating performance;

the severity and duration of declines in the fair value of its net assets related to its capital stock amount;

its commitment to make payments required by law or regulation and the level of such payments in relation to its operating performance;

the impact of legislative and regulatory changes on the FHLB, and accordingly, on the members of FHLB; and

its liquidity and funding position

After evaluating all of these considerations, the Corporation concluded that the par value of its investment in FHLB stock will be recovered. Accordingly, no impairment charge was recorded on these securities. Our evaluation of the factors described above in future periods could result in the recognition of impairment charges on FHLB stock.

**DEPOSITS**

Total deposits at June 30, 2011 and December 31, 2010 are summarized as follows (in thousands):

|                                | Percentage<br>Change | June 30, 2011 | December 31, 2010 |
|--------------------------------|----------------------|---------------|-------------------|
| Checking, non-interest bearing | 5.1%                 | \$ 148,022    | \$ 140,836        |
| Checking, interest bearing     | 5.6%                 | 300,610       | 284,538           |
| Savings accounts               | 32.3%                | 487,118       | 368,055           |
| Certificates of deposit        | (15.2%)              | 313,322       | 369,439           |
|                                | 7.4%                 | \$ 1,249,072  | \$ 1,162,868      |

**EARNINGS PER SHARE**

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Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the applicable period, excluding outstanding participating securities. Diluted earnings per share is computed using the weighted average number of shares determined for the basic computation plus the dilutive effect of potential common shares issuable under certain stock compensation plans. For the three and six months ended June 30, 2011, 84,250 shares issuable pursuant to outstanding stock options were excluded from the diluted earnings per share calculations since they were anti-dilutive. For the three and six months ended June 30, 2010, 86,750 shares issuable pursuant to outstanding stock options were excluded from the diluted earnings per share calculations since they were anti-dilutive.

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Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are included in the computation of earnings per share pursuant to the two-class method. The Corporation has determined that its outstanding non-vested stock awards are participating securities.

The computation of basic and diluted earnings per share is shown below (in thousands except per share data):

|                                                                                                  | Three months<br>ended<br>June 30, |          | Six months<br>ended<br>June 30, |          |
|--------------------------------------------------------------------------------------------------|-----------------------------------|----------|---------------------------------|----------|
|                                                                                                  | 2011                              | 2010     | 2011                            | 2010     |
| <b>Basic earnings per common share computation:</b>                                              |                                   |          |                                 |          |
| Distributed earnings allocated to common stock                                                   | \$ 2,021                          | \$ 1,447 | \$ 4,038                        | \$ 2,892 |
| Undistributed earnings allocated to common stock                                                 | 1,558                             | 1,665    | 3,107                           | 2,371    |
| Net earnings allocated to common stock                                                           | \$ 3,879                          | \$ 3,112 | \$ 7,145                        | \$ 5,263 |
| Weighted average common shares outstanding, including shares considered participating securities | 12,291                            | 9,253    | 12,277                          | 9,019    |
| Less: Average participating securities                                                           | (36)                              | (31)     | (37)                            | (32)     |
| Weighted average shares                                                                          | 12,255                            | 9,222    | 12,240                          | 8,987    |
| Basic earnings per common share                                                                  | \$ 0.32                           | \$ 0.34  | \$ 0.58                         | \$ 0.59  |
| <b>Diluted earnings per common share computation:</b>                                            |                                   |          |                                 |          |
| Net earnings allocated to common stock                                                           | \$ 3,879                          | \$ 3,112 | \$ 7,145                        | \$ 5,263 |
| Weighted average common shares outstanding for basic earnings per common share                   | 12,255                            | 9,222    | 12,240                          | 8,987    |
| Add: Dilutive effects of assumed exercises of stock options                                      | 6                                 | 9        | 7                               | 11       |
| Weighted average shares and dilutive potential common shares                                     | 12,261                            | 9,231    | 12,247                          | 8,998    |
| Diluted earnings per common share                                                                | \$ 0.32                           | \$ 0.34  | \$ 0.58                         | \$ 0.58  |

**DERIVATIVE INSTRUMENTS**

The Corporation records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and the resulting designation. Derivatives used to hedge the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives used to hedge the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges.

For derivatives designated as cash flow hedges, the effective portion of the changes in the fair value of the derivative is initially reported in other comprehensive income (outside of earnings) and subsequently reclassified into earnings when the hedged transaction affects earnings, and the ineffective portion of changes in the fair value of the derivative is recognized directly in earnings. The Corporation assesses the effectiveness of each hedging relationship by comparing the changes in cash flows of the derivative hedging instrument with the changes in cash flows of the designated hedged item or transaction.

On August 1, 2008, the Corporation executed an interest rate swap agreement with a 5 year term and an effective date of September 15, 2008 in order to hedge \$10 million of a subordinated note that was entered into by the Corporation during 2007 and elected cash flow hedge accounting for the agreement. The Corporation's objective in using this derivative is to add stability to interest expense and to manage its exposure to interest rate risk. The interest rate swap involves the receipt of variable-rate amounts in exchange for fixed-rate payments from August 1, 2008 to September 15, 2013 without exchange of the underlying notional amount. At June 30, 2011, the variable rate on the subordinated debt was 1.80% (LIBOR plus 155 basis points) and the Corporation was paying 5.84% (4.29% fixed rate plus 155 basis points).





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In anticipation of the expiration of the 5 year interest rate swap agreement discussed immediately above, on May 3, 2011, the Corporation executed an interest rate swap agreement with a 5 year term and an effective date of September 15, 2013 which as of that effective date, will hedge \$10 million of the subordinated note discussed immediately above. As with the prior interest rate swap agreement, the Corporation's objective in using this derivative is to add stability to interest expense and to manage its exposure to interest rate risk. The interest rate swap involves the receipt of variable-rate amounts in exchange for fixed-rate payments from September 15, 2013 to September 15, 2018 without exchange of the underlying notional amount. On the effective date, the variable rate on the subordinated debt will be LIBOR plus 155 basis points and the Corporation will be paying 5.57% (4.02% fixed rate plus 155 basis points).

As of June 30, 2011, no derivatives were designated as fair value hedges or hedges of net investments in foreign operations. Additionally, the Corporation does not use derivatives for trading or speculative purposes and currently does not have any derivatives that are not designated as hedges.

The following tables provide information about the amounts and locations of activity related to the interest rate swaps designated as cash flow hedges within the Corporation's consolidated balance sheet and statement of income as of and for the three and six months ended June 30, 2011 (in thousands):

**As of June 30, 2011**

|                        | Liability Derivative     |            |
|------------------------|--------------------------|------------|
|                        | Balance Sheet Location   | Fair Value |
|                        | Accrued interest payable |            |
| Interest rate contract | and other liabilities    | \$ (987)   |

**For the Three Months Ended June 30, 2011**

|                        | (a)     | (b)                     | (c)     | (d)          | (e) |
|------------------------|---------|-------------------------|---------|--------------|-----|
|                        |         | Interest expense        |         |              |     |
| Interest rate contract | \$(145) | subordinated debentures | \$(101) | Other income | \$  |

**For the Six Months Ended June 30, 2011**

|                        | (a)    | (b)                     | (c)     | (d)          | (e) |
|------------------------|--------|-------------------------|---------|--------------|-----|
|                        |        | Interest expense        |         |              |     |
| Interest rate contract | \$(78) | subordinated debentures | \$(201) | Other income | \$  |

- (a) Amount of Gain or (Loss) Recognized in Other Comprehensive Loss on Derivative (Effective Portion), net of tax
  - (b) Location of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)
  - (c) Amount of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)
  - (d) Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
  - (e) Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
- Amounts reported in accumulated other comprehensive loss related to the interest rate swap will be reclassified to interest expense as interest payments are made on the subordinated debentures. Such amounts reclassified from accumulated other comprehensive loss to interest expense in the next 12 months are expected to approximate \$404.

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**Table of Contents****RECENT ACCOUNTING PRONOUNCEMENTS**

In December 2010, the FASB issued Accounting Standards Update No. 2010-29, Disclosure of Supplementary Pro Forma Information for Business Combinations. This update addresses diversity in practice about the interpretation of the pro forma revenue and earnings disclosure requirements for business combinations. The amendments in the update specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. The effect of adopting this new guidance did not have a material effect on the Corporation's financial statements.

In January 2011, the FASB issued Accounting Standards Update No. 2011-01, Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20. The provisions of Update No. 2010-20 required the disclosure of more granular information on the nature and extent of troubled debt restructurings and their effect on the allowance for loan losses effective for the Corporation's reporting period ended March 31, 2011. The amendments in Update No. 2011-01 defer the effective date related to these disclosures, enabling creditors to provide such disclosures after the FASB completes their project clarifying the guidance for determining what constitutes a troubled debt restructuring. As the provisions of this update only defer the effective date of disclosure requirements related to troubled debt restructurings, the adoption of this update will have no impact on the Corporation's financial statements.

In April 2011, the FASB issued Accounting Standards Update No. 2011-02, A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring. This update clarifies guidance on a creditor's evaluation of whether it has granted a concession to a borrower and a creditor's evaluation of whether a borrower is experiencing financial difficulties. The amendments in this update are effective for the first interim or annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. As a result of applying these amendments, an entity may identify receivables that are newly considered impaired. For purposes of measuring impairment of those receivables, an entity should apply the amendments prospectively for the first interim or annual period beginning on or after June 15, 2011. In addition, an entity should disclose the information required by Accounting Standards Codification paragraphs 310-10-50-33 through 50-34, which was deferred by Accounting Standards Update No. 2011-01, for interim and annual periods beginning on or after June 15, 2011. The effect of adopting this new guidance is not expected to have a material effect on the Corporation's financial statements.

In May 2011, the FASB issued Accounting Standards Update No. 2011-4, Fair Value Measurement (Topic 820), Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. Some amendments in this update clarify the FASB's intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The amendments in this update are effective during interim and annual reporting periods beginning after December 15, 2011. The effect of adopting this new guidance is not expected to have a material effect on the Corporation's financial statements.

In June 2011, the FASB issued Accounting Standards Update No. 2011-5, Comprehensive Income (Topic 220), Presentation of Comprehensive Income. This update amends the FASB Accounting Standards Codification (Codification) to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This update eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments to the Codification in this update do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The amendments in this update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, and retrospective application is required. The effect of adopting this new guidance is not expected to have a material effect on the Corporation's financial statements.

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**ITEM 2**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION**

**AND RESULTS OF OPERATIONS**

The following discussion and analysis of the consolidated financial statements of CNB Financial Corporation (the Corporation) is presented to provide insight into management's assessment of financial results. The Corporation's principal subsidiary, CNB Bank (the Bank), provides financial services to individuals and businesses primarily within the west central Pennsylvania counties of Cambria, Cameron, Clearfield, Elk, McKean and Warren. It also includes a portion of western Centre County including Philipsburg Borough, Rush Township and the western portions of Snow Shoe and Burnside Townships and a portion of Jefferson County, consisting of the boroughs of Brockway, Falls Creek, Punxsutawney, Reynoldsville and Sykesville, and the townships of Washington, Winslow and Henderson. ERIEBANK, a division of CNB Bank, provides financial services to individuals and businesses in the northwestern Pennsylvania counties of Erie and Crawford.

The Bank is subject to regulation, supervision and examination by the Pennsylvania State Department of Banking as well as the Federal Deposit Insurance Corporation. The financial condition and results of operations of the Corporation and its consolidated subsidiaries are not necessarily indicative of future performance. One of the Corporation's subsidiaries, CNB Securities Corporation, is incorporated in Delaware and currently maintains investments in debt and equity securities. County Reinsurance Company, also a subsidiary, is an Arizona Corporation, and provides credit life and disability insurance for customers of CNB Bank. CNB Insurance Agency, incorporated in Pennsylvania, provides for the sale of nonproprietary annuities and other insurance products. Holiday Financial Services Corporation, incorporated in Pennsylvania, offers small balance unsecured loans and secured loans, primarily collateralized by automobiles and equipment, to borrowers with higher risk characteristics. When we use the terms we, us and our, we mean CNB Financial Corporation and its subsidiaries. Management's discussion and analysis should be read in conjunction with the Corporation's consolidated financial statements and related notes.

**GENERAL OVERVIEW**

The Corporation expanded its ERIEBANK division by opening a full service office in Meadville, Pennsylvania in the second quarter of 2010. In addition, a CNB Bank branch was opened in Kylertown, Pennsylvania in the third quarter of 2010. Management believes that our ERIEBANK division, along with our traditional CNB Bank market areas, should provide the Bank with sustained loan growth during 2011. Deposit growth was significant in 2010 and the first six months of 2011.

Management concentrates on return on average equity and earnings per share evaluations, plus other methods to measure and direct the performance of the Corporation. The interest rate environment will continue to play an important role in the future earnings of the Corporation. We experienced some compression of our net interest margin in the first six months of 2011 and some additional compression is expected throughout the remainder of 2011 as a result of the current interest rate environment. During the past several years, we have taken measures such as instituting rate floors on our commercial lines of credit and home equity lines as a result of the historic lows on various key interest rates such as the Prime Rate and 3-month LIBOR. In addition, we decreased interest rates on certain deposit products during 2010.

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street and Consumer Protection Act (the Dodd-Frank Act) that could impact the performance of the Corporation in future periods. The Dodd-Frank Act includes numerous provisions designed to strengthen the financial industry, enhance consumer protection, expand disclosures and provide for transparency. Some of these provisions include changes to FDIC insurance coverage, which includes a permanent increase in the coverage to \$250,000. Additional provisions create a Consumer Financial Protection Bureau, which is authorized to write rules on all consumer financial products, and a Financial Services Oversight Council, which is empowered to determine which entities are systematically significant and require tougher regulations and is charged with reviewing, and when appropriate, submitting comments to the Securities and Exchange Commission and Financial Accounting Standards Board with respect to existing or proposed accounting principles, standards or procedures. Although the aforementioned provisions are only a few of the numerous ones included in the Dodd-Frank Act, the full impact of the entire Dodd-Frank Act will not be known until the full implementation is completed.

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### **CASH AND CASH EQUIVALENTS**

Cash and cash equivalents totaled \$43.6 million at June 30, 2011 compared to \$37.4 million at December 31, 2010. Cash and cash equivalents will fluctuate based on the timing and amount of liquidity events that occur in the normal course of business.

We believe the liquidity needs of the Corporation are satisfied by the current balance of cash and cash equivalents, readily available access to traditional funding sources, and the portion of the investment and loan portfolios that mature within one year. These sources of funds will enable the Corporation to meet cash obligations and off-balance sheet commitments as they come due.

### **SECURITIES**

Securities available for sale and trading securities have combined to increase \$47.5 million or 9.5% since December 31, 2010. The increase is primarily the result of purchases of residential mortgage and asset backed securities issued by government sponsored entities and resulted from deposit growth not reinvested in loans.

The Corporation's structured pooled trust preferred securities currently do not trade in an active, open market with readily observable prices and are therefore classified within Level 3 of the valuation hierarchy. The fair value of these securities has been calculated using a discounted cash flow model and market liquidity premium. With the current market conditions, the assumptions used to determine the fair value of Level 3 securities has greater subjectivity due to the lack of observable market transactions. The fair values of these securities have declined due to the fact that the subsequent offerings of similar securities pay a higher market rate of return. The higher rate of return reflects the increased credit and liquidity risks in the market.

When the structured pooled trust preferred securities were purchased, they were considered to be investment grade based on ratings assigned by Moody's. As a result of liquidity disruptions within the credit markets and the generally stressed conditions within the financial services industry, Moody's has downgraded the rating of these securities since they were purchased by the Corporation. As of June 30, 2011, the Corporation held one structured pooled trust preferred security rated Ca by Moody's having an amortized cost of \$800 thousand and fair value of \$380 thousand. The present value of the projected cash flows for this security was sufficient for full repayment of the amortized cost; therefore, it is believed the decline in fair value is temporary due to current market conditions. However, without recovery, other-than-temporary impairments may occur in future periods.

In addition, the Corporation holds two structured pooled trust preferred securities for which an impairment charge of \$398 thousand was recorded during the six months ended June 30, 2011 since the present value of the projected cash flows was not sufficient for repayment of any of the amortized cost of the securities.

The Corporation generally buys into the market over time and does not attempt to time its transactions. In doing this, the highs and lows of the market are averaged into the portfolio and minimize the overall effect of different rate environments. We monitor the earnings performance and the effectiveness of the liquidity of the securities portfolio on a regular basis through meetings of the Asset/Liability Committee of the Corporation's Board of Directors (ALCO). The ALCO also reviews and manages interest rate risk for the Corporation. Through active balance sheet management and analysis of the securities portfolio, we maintain a sufficient level of liquidity to satisfy depositor requirements and various credit needs of our customers.

### **LOANS**

The Corporation experienced an increase in loans, net of unearned discount, of \$27.2 million, or 3.4%, during the first six months of 2011. Our lending is focused in the west, central and northwest Pennsylvania markets and consists principally of commercial and retail lending, which includes single family residential mortgages and other consumer loans. The Corporation views commercial lending as its competitive advantage and continues to focus on this area by hiring and retaining experienced loan officers and supporting them with quality credit analysis. The Corporation expects improved loan demand throughout the remainder of 2011.

**Table of Contents****ALLOWANCE FOR LOAN LOSSES**

The allowance for loan losses is established by provisions for losses in the loan portfolio as well as overdrafts in deposit accounts. These provisions are charged against current income. Loans and overdrafts deemed not collectible are charged off against the allowance while any subsequent collections are recorded as recoveries and increase the allowance. The table below shows activity within the allowance account for the specified periods (in thousands):

|                                          | Six months ending<br>June 30, 2011 | Year ending<br>December 31, 2010 | Six months ending<br>June 30, 2010 |
|------------------------------------------|------------------------------------|----------------------------------|------------------------------------|
| Balance at beginning of period           | \$ 10,820                          | \$ 9,795                         | \$ 9,795                           |
| Charge-offs:                             |                                    |                                  |                                    |
| Commercial, industrial, and agricultural | 215                                | 543                              | 226                                |
| Commercial mortgages                     | 88                                 | 2,061                            | 91                                 |
| Residential real estate                  | 77                                 | 211                              | 175                                |
| Consumer                                 | 462                                | 1,223                            | 625                                |
| Credit cards                             | 25                                 | 94                               | 31                                 |
| Overdrafts                               | 115                                | 239                              | 108                                |
|                                          | 982                                | 4,371                            | 1,256                              |
| Recoveries:                              |                                    |                                  |                                    |
| Commercial, industrial, and agricultural | 4                                  | 11                               | 3                                  |
| Commercial mortgages                     |                                    | 3                                | 3                                  |
| Residential real estate                  |                                    | 2                                | 3                                  |
| Consumer                                 | 45                                 | 100                              | 51                                 |
| Credit cards                             | 5                                  | 10                               | 4                                  |
| Overdraft deposit accounts               | 54                                 | 112                              | 66                                 |
|                                          | 108                                | 238                              | 130                                |
| Net charge-offs                          | (874)                              | (4,133)                          | (1,126)                            |
| Provision for loan losses                | 1,769                              | 5,158                            | 1,746                              |
| Balance at end of period                 | \$ 11,715                          | \$ 10,820                        | \$ 10,415                          |
| Loans, net of unearned                   | \$ 821,787                         | \$ 794,562                       | \$ 741,210                         |
| Allowance to net loans                   | 1.43%                              | 1.36%                            | 1.41%                              |
| Net charge-offs to average loans         | 0.22%                              | 0.56%                            | 0.31%                              |
| Nonperforming assets                     | \$ 18,368                          | \$ 13,211                        | \$ 12,004                          |
| Nonperforming % of total assets          | 1.23%                              | 0.93%                            | 1.62%                              |

The adequacy of the allowance for loan losses is subject to a formal analysis by the credit administrator of the Corporation. As part of the formal analysis, delinquencies and losses are monitored monthly. The loan portfolio is divided into several categories in order to better analyze the entire pool. First is a selection of classified loans that is given a specific reserve.

The remaining loans are pooled, by category, into these segments:

**Reviewed**

Commercial, industrial, and agricultural

Commercial mortgages

Homogeneous

Residential real estate

Consumer

Credit cards

Overdrafts

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The reviewed loan pools are further segregated into four categories: special mention, substandard, doubtful, and unclassified. Historical loss factors are calculated for each pool excluding overdrafts based on the previous eight quarters of experience. The homogeneous pools are evaluated by analyzing the historical loss factors from the most previous quarter end and the two most recent year ends. The historical loss factors for both the reviewed and homogeneous pools are adjusted based on these six qualitative factors:

Levels of and trends in delinquencies, non-accrual loans, and classified loans

Trends in volume and terms of loans

Effects of any changes in lending policies and procedures

Experience, ability and depth of management

National and local economic trends and conditions

### Concentrations of credit

The methodology described above was created using the experience of our credit administrator, guidance from the regulatory agencies, expertise of our third party loan review provider, and discussions with our peers. The resulting factors are applied to the pool balances in order to estimate the probable risk of loss within each pool. Prudent business practices dictate that the level of the allowance, as well as corresponding charges to the provision for loan losses, should be commensurate with identified areas of risk within the loan portfolio and the attendant risks inherent therein. The quality of the credit risk management function and the overall administration of this vital segment of the Corporation's assets are critical to the ongoing success of the Corporation.

The previously mentioned analysis considered numerous historical and other factors to analyze the adequacy of the allowance and current period charges against the provision for loan losses. Management paid special attention to a section of the analysis that compared and plotted the actual level of the allowance against the aggregate amount of loans adversely classified in order to compute the estimated probable losses associated with those loans. By noting the spread at the present time, as well as prior periods, management can determine the current adequacy of the allowance as well as evaluate trends that may be developing. The volume and composition of the Corporation's loan portfolio continue to reflect growth in commercial credits including commercial real estate loans.

As mentioned in the Loans section of this analysis, management considers commercial lending a competitive advantage and continues to focus on this area as part of its strategic growth initiatives. However, management must also consider the fact that the inherent risk is more pronounced in these types of credits and is also driven by the economic environment of its market areas.

During the six months ended June 30, 2011, the Corporation recorded a provision for loan losses of \$1.8 million, as compared to a provision for loan losses of \$1.7 million for the six months ended June 30, 2010. One relationship comprising three commercial loans became impaired in the first quarter of 2011, resulting in an increase in nonperforming assets of \$4.4 million. As of June 30, 2011, one of these loans in the amount of \$1.4 million remains nonperforming. Based on CNB's evaluation of the underlying collateral, no losses associated with this relationship are expected.

One relationship comprising two commercial loans became impaired in the second quarter of 2011, resulting in an increase in non-accrual loans of \$4.2 million and an increase in the provision and allowance for loan losses of \$433 thousand. This increase in the provision and allowance for loan losses was offset by a decrease in the provision for loan losses resulting from a decrease in net loan chargeoffs from \$1.1 million for the six months ended June 30, 2010 to \$882 thousand for the six months ended June 30, 2011.

Management believes that both its 2011 provision and allowance for loan losses are reasonable and adequate to absorb probable incurred losses in its portfolio at June 30, 2011.

**BANK OWNED LIFE INSURANCE**

The Corporation has periodically purchased Bank Owned Life Insurance ( BOLI ). The policies cover executive officers and a select group of other employees with the Bank being named as beneficiary. Earnings from the BOLI assist the Corporation in offsetting its benefit costs. During the first quarter of 2011, additional BOLI of \$5.0 million was purchased.



**Table of Contents****FUNDING SOURCES**

The Corporation considers deposits, short-term borrowings, and term debt when evaluating funding sources. Traditional deposits continue to be the main source of funds in the Corporation, increasing \$86.2 million from \$1,162.9 million at December 31, 2010 to \$1,249.1 million at June 30, 2011. The growth in deposits was primarily due to increases in savings accounts of \$119.1 million over this period as a result of the Corporation's marketing of a new savings product which carries a highly competitive annual percentage yield in the current interest rate environment. This increase in savings accounts was offset by an expected decrease in time deposits of \$56.1 million as customers who previously held certificates of deposit migrate to the new savings product.

Periodically, the Corporation utilizes term borrowings from the Federal Home Loan Bank ( FHLB ) and other lenders to meet funding needs. Management plans to maintain access to short- and long-term borrowings as an available funding source when deemed appropriate.

**SHAREHOLDERS EQUITY AND CAPITAL RATIOS AND METRICS**

The Corporation's capital continued to provide a base for profitable growth through June 30, 2011. Total shareholders' equity was \$122.2 million at June 30, 2011 and \$109.6 million at December 31, 2010. In the first six months of 2011, the Corporation earned \$7.2 million and declared dividends of \$4.1 million, a dividend payout ratio of 56.5% of net income. The Corporation has also complied with the standards of capital adequacy mandated by the banking regulators. Bank regulators have established risk-based capital requirements designed to measure capital adequacy. Risk-based capital ratios reflect the relative risks of various assets banks hold in their portfolios. A weight category of 0% (lowest risk assets), 20%, 50%, or 100% (highest risk assets), is assigned to each asset on the balance sheet.

The Corporation's capital ratios, book value per share and tangible book value per share as of June 30, 2011 and December 31, 2010 are as follows:

|                                            | June 30, 2011 | December 31, 2010 |
|--------------------------------------------|---------------|-------------------|
| Total risk-based capital ratio             | 15.28%        | 15.38%            |
| Tier 1 capital ratio                       | 14.02%        | 14.13%            |
| Leverage ratio                             | 8.47%         | 8.81%             |
| Tangible common equity/tangible assets (1) | 7.53%         | 7.05%             |
| Book value per share                       | \$ 9.93       | \$ 8.96           |
| Tangible book value per share (1)          | \$ 9.05       | \$ 8.08           |

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- (1) Tangible common equity, tangible assets and tangible book value per share are non-GAAP financial measures calculated using GAAP amounts. Tangible common equity is calculated by excluding the balance of goodwill from the calculation of stockholders' equity. Tangible assets is calculated by excluding the balance of goodwill from the calculation of total assets. Tangible book value per share is calculated by dividing tangible common equity by the number of shares outstanding. The Corporation believes that these non-GAAP financial measures provide information to investors that is useful in understanding its financial condition because they are additional measures used to assess capital adequacy. Because not all companies use the same calculation of tangible common equity and tangible assets, this presentation may not be comparable to other similarly titled measures calculated by other companies. A reconciliation of these non-GAAP financial measures is provided below (dollars in thousands, except per share data).

|                                        | June 30, 2011     | December 31, 2010 |
|----------------------------------------|-------------------|-------------------|
| Shareholders' equity                   | \$ 122,230        | \$ 109,645        |
| Less goodwill                          | 10,821            | 10,821            |
| <b>Tangible common equity</b>          | <b>\$ 111,409</b> | <b>\$ 98,824</b>  |
| Total assets                           | \$ 1,491,194      | \$ 1,413,511      |
| Less goodwill                          | 10,821            | 10,821            |
| Tangible assets                        | \$ 1,480,373      | \$ 1,402,690      |
| Ending shares outstanding              | 12,305,639        | 12,237,261        |
| Tangible book value per share          | \$ 9.05           | \$ 8.08           |
| Tangible common equity/tangible assets | 7.53%             | 7.05%             |

**LIQUIDITY**

Liquidity measures an organization's ability to meet cash obligations as they come due. The consolidated statement of cash flows presented on page 8 provides analysis of the Corporation's cash and cash equivalents. Additionally, management considers that portion of the loan and investment portfolio that matures within one year as part of the Corporation's liquid assets. The Corporation's liquidity is monitored by both management and the ALCO, which establishes and monitors ranges of acceptable liquidity. Management believes the Corporation's current liquidity position is acceptable.

**OFF BALANCE SHEET ACTIVITIES**

Some financial instruments, such as loan commitments, credit lines, letters of credit and overdraft protection, are issued to meet customer financing needs. The contractual amount of financial instruments with off-balance sheet risk was as follows at June 30, 2011 (in thousands):

|                              |                   |
|------------------------------|-------------------|
| Commitments to extend credit | \$ 214,022        |
| Standby letters of credit    | 23,135            |
|                              | <b>\$ 237,157</b> |

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## CONSOLIDATED YIELD COMPARISONS

## AVERAGE BALANCES AND NET INTEREST MARGIN FOR THE SIX MONTHS ENDED

Dollars in thousands

|                                              | Average<br>Balance  | June 30, 2011<br>Annual<br>Rate | Interest<br>Inc./Exp. | Average<br>Balance  | June 30, 2010<br>Annual<br>Rate | Interest<br>Inc./Exp. |
|----------------------------------------------|---------------------|---------------------------------|-----------------------|---------------------|---------------------------------|-----------------------|
| <b>ASSETS:</b>                               |                     |                                 |                       |                     |                                 |                       |
| Interest-bearing deposits with other banks   | \$ 15,741           | 1.04%                           | \$ 82                 | \$ 7,089            | 1.78%                           | \$ 63                 |
| <b>Securities:</b>                           |                     |                                 |                       |                     |                                 |                       |
| Taxable (1)                                  | 462,710             | 3.00%                           | 6,951                 | 351,238             | 2.95%                           | 5,269                 |
| Tax-Exempt (1,2)                             | 79,828              | 5.17%                           | 2,057                 | 57,138              | 5.38%                           | 1,506                 |
| Equity Securities (1,2)                      | 1,666               | 2.43%                           | 20                    | 1,658               | 2.17%                           | 18                    |
| <b>Total securities</b>                      | <b>544,204</b>      | <b>3.32%</b>                    | <b>9,028</b>          | <b>410,034</b>      | <b>3.28%</b>                    | <b>6,793</b>          |
| <b>Loans:</b>                                |                     |                                 |                       |                     |                                 |                       |
| Commercial (2)                               | 277,139             | 5.21%                           | 7,214                 | 254,637             | 5.75%                           | 7,317                 |
| Mortgage (2)                                 | 474,594             | 5.72%                           | 13,582                | 416,933             | 6.21%                           | 12,940                |
| Consumer                                     | 49,757              | 12.69%                          | 3,157                 | 49,448              | 13.15%                          | 3,251                 |
| <b>Total loans (3)</b>                       | <b>801,490</b>      | <b>5.98%</b>                    | <b>23,953</b>         | <b>721,018</b>      | <b>6.52%</b>                    | <b>23,508</b>         |
| <b>Total earning assets</b>                  | <b>1,361,435</b>    | <b>4.86%</b>                    | <b>\$ 33,063</b>      | <b>1,138,141</b>    | <b>5.32%</b>                    | <b>\$ 30,364</b>      |
| <b>Non interest-bearing assets:</b>          |                     |                                 |                       |                     |                                 |                       |
| Cash and due from banks                      | 33,408              |                                 |                       | 39,067              |                                 |                       |
| Premises and equipment                       | 24,420              |                                 |                       | 23,994              |                                 |                       |
| Other assets                                 | 58,049              |                                 |                       | 54,056              |                                 |                       |
| Allowance for loan losses                    | (11,332)            |                                 |                       | (10,040)            |                                 |                       |
| <b>Total non interest-bearing assets</b>     | <b>104,545</b>      |                                 |                       | <b>107,077</b>      |                                 |                       |
| <b>TOTAL ASSETS</b>                          | <b>\$ 1,465,980</b> |                                 |                       | <b>\$ 1,245,218</b> |                                 |                       |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY:</b> |                     |                                 |                       |                     |                                 |                       |
| Demand interest-bearing                      | \$ 288,874          | 0.83%                           | 1,202                 | \$ 245,968          | 0.72%                           | 889                   |
| Savings                                      | 434,867             | 1.15%                           | 2,503                 | 328,971             | 1.41%                           | 2,315                 |
| Time                                         | 354,966             | 1.82%                           | 3,231                 | 340,838             | 2.11%                           | 3,604                 |
| <b>Total interest-bearing deposits</b>       | <b>1,078,707</b>    | <b>1.29%</b>                    | <b>6,936</b>          | <b>915,777</b>      | <b>1.49%</b>                    | <b>6,808</b>          |
| Short-term borrowings                        | 16,975              | 0.31%                           | 26                    | 1,863               | 0.21%                           | 2                     |
| Long-term borrowings                         | 73,971              | 4.19%                           | 1,551                 | 95,760              | 4.54%                           | 2,175                 |
| Subordinated debentures                      | 20,620              | 3.75%                           | 387                   | 20,620              | 3.73%                           | 385                   |
| <b>Total interest-bearing liabilities</b>    | <b>1,190,273</b>    | <b>1.50%</b>                    | <b>\$ 8,900</b>       | <b>1,034,020</b>    | <b>1.81%</b>                    | <b>\$ 9,370</b>       |
| Demand non interest-bearing                  | 145,661             |                                 |                       | 119,077             |                                 |                       |
| Other liabilities                            | 14,804              |                                 |                       | 12,811              |                                 |                       |
| <b>Total liabilities</b>                     | <b>1,350,738</b>    |                                 |                       | <b>1,165,908</b>    |                                 |                       |

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|                                               |              |           |              |           |
|-----------------------------------------------|--------------|-----------|--------------|-----------|
| Shareholders equity                           | 115,242      |           | 79,310       |           |
| TOTAL LIABILITIES AND SHAREHOLDERS EQUITY     | \$ 1,465,980 |           | \$ 1,245,218 |           |
| Interest income/Earning assets                | 4.86%        | \$ 33,063 | 5.32%        | \$ 30,364 |
| Interest expense/Interest-bearing liabilities | 1.50%        | 8,900     | 1.81%        | 9,370     |
| Net interest spread                           | 3.37%        | \$ 24,163 | 3.51%        | \$ 20,994 |
| Interest income/Earning assets                | 4.86%        | 33,063    | 5.32%        | 30,364    |
| Interest expense/Earning assets               | 1.31%        | 8,900     | 1.65%        | 9,370     |
| Net interest margin                           | 3.55%        | \$ 24,163 | 3.67%        | \$ 20,994 |

- (1) Includes unamortized discounts and premiums. Average balance is computed using the carrying value of securities. The average yield has been computed using the historical amortized cost average balance for available for sale securities.
- (2) Average yields are stated on a fully taxable equivalent basis.
- (3) Average outstanding includes the average balance outstanding of all non-accrual loans. Loans consist of the average of total loans less average unearned income. The amount of loan fees included in the interest income on loans is not material.

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**RESULTS OF OPERATIONS**

**Three Months Ended June 30, 2011 and 2010**

**OVERVIEW OF THE INCOME STATEMENT**

The Corporation had net income of \$3.9 million for the second quarter of 2011 compared to \$3.1 million for the same period of 2010. The earnings per diluted share was \$0.32 in the second quarter of 2011 and \$0.34 for the second quarter of 2010.

**INTEREST INCOME AND EXPENSE**

Net interest income totaled \$11.9 million, an increase of \$1.2 million, or 11.5%, over the second quarter of 2010. Total interest and dividend income increased by \$1.1 million, or 7.1%, as compared to the second quarter of 2010. Although the Corporation's earning assets continue to grow, these increases have been offset by decreases in the yield on earning assets, primarily because the composition of earning assets has shifted to a greater percentage of investment securities as deposit growth has exceeded loan growth. Total interest expense decreased \$138 thousand, or 3.0%, as compared to the second quarter of 2010 due to decreases in the cost of core deposits as well as the Corporation's repayment and refinancing of long-term debt in 2010.

**PROVISION FOR LOAN LOSSES**

The Corporation recorded a provision for loan losses of \$992 thousand in the second quarter of 2011 compared to \$1.2 million in the second quarter of 2010. Net loan chargeoffs were \$501 thousand in the second quarter of 2011 compared to \$660 thousand in the second quarter of 2010, and loan growth was consistent from the second quarter of 2010 to the second quarter of 2011. As a result, a lower provision for loan losses was required in the second quarter of 2011 than in the second quarter of 2010.

Management believes the provision for loan losses is appropriate and the allowance for loan losses is adequate to absorb probable incurred losses in our portfolio as of June 30, 2011.

**NON-INTEREST INCOME**

Non-interest income totaled \$2.6 million, an increase of \$608 thousand, or 30.3%, over the second quarter of 2010. The Corporation recorded other-than-temporary impairment charges in the second quarter of 2010 of \$318 thousand, which was offset by realized gains on available-for-sale securities of \$141 thousand. No other-than-temporary impairment charges or realized gains were recorded in the second quarter of 2011. In addition, the Corporation recorded realized and unrealized losses during the quarters ended June 30, 2011 and 2010 of \$16 thousand and \$210 thousand, respectively, for securities for which the fair value option was elected.

Excluding the effects of securities transactions, the Corporation's non-interest income increased \$237 thousand, or 9.9%, in the second quarter of 2011 as compared to the same period in 2010. Mortgage banking income increased \$107 thousand from the three months ended June 30, 2010 to the three months ended June 30, 2011, primarily as a result of the Corporation's decision not to sell loans in the secondary market in the second quarter of 2010.

**NON-INTEREST EXPENSE**

Non-interest expense totaled \$8.1 million, an increase of \$810 thousand, or 11.0%, over the second quarter of 2010. Salaries and benefits expenses increased \$483 thousand, or 13.0%, during the quarter ended June 30, 2011 compared to the quarter ended June 30, 2010, primarily as a result of an increase in full-time equivalent employees from 287 at June 30, 2010 to 296 at June 30, 2011.

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**INCOME TAX EXPENSE**

Income tax expense was \$1.5 million in the second quarter of 2011 as compared to \$1.1 million in the second quarter of 2010, resulting in an effective tax rate of 27.9% and 25.6%, respectively. The effective rate for the periods differed from the federal statutory rate of 35.0% principally as a result of tax exempt income from securities and loans as well as earnings from bank owned life insurance.

**Six Months Ended June 30, 2011 and 2010**

**OVERVIEW OF THE INCOME STATEMENT**

The Corporation had net income of \$7.2 million for the six months ended June 30, 2011 compared to \$5.3 million for the same period of 2010. The earnings per diluted share was \$0.58 for both the six months ended June 30, 2011 and 2010. The return on assets and return on equity for the six months ended June 30, 2011 are 0.98% and 12.44%, respectively, compared to 0.85% and 13.32%, respectively, for the same period of 2010.

**INTEREST INCOME AND EXPENSE**

During the six months ended June 30, 2011, net interest income increased \$3.1 million, or 15.3%, compared to the comparable period in 2010. The Corporation's net interest margin on a fully tax equivalent basis was 3.55% for the six months ended June 30, 2011, compared to 3.67% for the comparable period in 2010. Although the Corporation's earning assets continue to grow, these increases have been offset by decreases in the yield on earning assets, primarily because the composition of earning assets has shifted to a greater percentage of investment securities as deposit growth has exceeded loan growth. During the six months ended June 30, 2011, total interest expense decreased \$470 thousand, or 5.0%, as compared to the comparable period in 2010 due to decreases in the cost of core deposits as well as the Corporation's repayment and refinancing of long-term debt in 2010.

**PROVISION FOR LOAN LOSSES**

The Corporation recorded a provision for loan losses of \$1.8 million for the six months ended June 30, 2011 compared to \$1.7 million for the comparable period in 2010. Net loan chargeoffs were \$874 thousand in the first six months of 2011 compared to \$1.1 million in the first six months of 2010, and loan growth was consistent from the first six months of 2010 to the first six months of 2011. However, as discussed in the Corporation's Form 10-Q for the quarter ended March 31, 2011, the Corporation recorded charge-offs in its commercial mortgage loan portfolio of \$1.9 million during the quarter ended December 31, 2010, as compared to \$381 thousand and \$178 thousand during the years ended December 31, 2009 and 2008. As a result, the Corporation's homogeneous loss pool associated with its commercial mortgage loan portfolio increased \$400 thousand during the three months ended March 31, 2011. In combination, all of these factors resulted in a slightly higher provision for loan losses in the first six months of 2011 than in the first six months of 2010.

Management believes the provision for loan losses is appropriate and the allowance for loan losses is adequate to absorb probable incurred losses in our portfolio as of June 30, 2011.

**NON-INTEREST INCOME**

Non-interest income totaled \$4.8 million during the six months ended June 30, 2011, an increase of \$723 thousand, or 17.7%, over the comparable period in 2010. During the six months ended June 30, 2011, the Corporation recorded other-than-temporary impairment charges of \$398 thousand, which was offset by realized gains on available-for-sale securities of \$74 thousand. The Corporation recorded other-than-temporary impairment charges during the six months ended June 30, 2010 of \$1.1 million, which was offset by realized gains on available-for-sale securities of \$573 thousand. In addition, the Corporation recorded realized and unrealized gains (losses) during the six months ended June 30, 2011 and 2010 of \$97 and (\$90), respectively, for securities for which the fair value option was elected.

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Excluding the effects of securities transactions, the Corporation's non-interest income was \$5.0 million for the six months ended June 30, 2011, compared to \$4.7 million for the six months ended June 30, 2010. Mortgage banking income increased \$85 thousand from the six months ended June 30, 2010 to the six months ended June 30, 2011, primarily as a result of the Corporation's decision not to sell loans in the secondary market in the second quarter of 2010.

### **NON-INTEREST EXPENSE**

Non-interest expense increased \$974 thousand, or 6.3%, during the six months ended June 30, 2011 compared to the comparable period in 2010. Salaries and benefits increased \$749 thousand, or 9.7%, during the six months ended June 30, 2011 compared to the comparable period in 2010, primarily as a result of an increase in full-time equivalent employees from 287 at June 30, 2010 to 296 at June 30, 2011.

### **INCOME TAX EXPENSE**

Income tax expense was \$2.6 million for the six months ended June 30, 2011 as compared to \$1.7 million for the same period of 2010, resulting in an effective tax rate of 27.0% and 24.5%, respectively. The effective rate for the periods differed from the federal statutory rate of 35.0% principally as a result of tax exempt income from securities and loans as well as earnings from bank owned life insurance.

### **CRITICAL ACCOUNTING POLICIES**

The Corporation's accounting and reporting policies are in accordance with GAAP and conform to general practices within the financial services industry. Accounting and reporting practices for the allowance for loan losses and fair value of securities are deemed critical since they involve the use of estimates and require significant management judgments. Application of assumptions different than those used by management could result in material changes in CNB Financial Corporation's financial position or results of operations. Note 1 (Summary of Significant Accounting Policies), Note 3 (Securities), and Note 4 (Loans), of the Corporation's 2010 Form 10-K, provide detail with regard to the Corporation's accounting for the allowance for loan losses and fair value of securities. There have been no significant changes in the application of accounting policies since December 31, 2010.

## **ITEM 3**

### **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, exchange rates, and equity prices. As a financial holding company, the Corporation is primarily sensitive to the interest rate risk component. Changes in interest rates will affect the levels of income and expense recorded on a large portion of the Bank's assets and liabilities. Additionally, such fluctuations in interest rates will impact the market value of all interest sensitive assets. The ALCO is responsible for reviewing the Corporation's interest rate sensitivity position and establishing policies to control exposure to interest rate fluctuations. The primary goal established by these policies is to increase total income within acceptable risk limits.

The Corporation monitors interest rate risk through the use of two models: static gap and earnings simulation. Each model standing alone has limitations; however, taken together they represent in management's opinion a reasonable view of the Corporation's interest rate risk position.

**STATIC GAP:** Gap analysis is intended to provide an approximation of projected repricing of assets and liabilities at a point in time on the basis of stated maturities, prepayments, and scheduled interest rate adjustments within selected time intervals. A gap is defined as the difference between the principal amount of assets and liabilities which reprice within those time intervals. The cumulative one year gap at June 30, 2011 was 7.18% of total earning assets compared to policy guidelines of plus or minus 15.0%. The ratio was 3.23% at December 31, 2010.

Fixed rate securities, loans and CDs are included in the gap repricing based on time remaining until maturity. Mortgage prepayments are included in the time frame in which they are expected to be received.

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Certain shortcomings are inherent in the method of analysis presented in Static Gap. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may not react correspondingly to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate with changes in market interest rates, while interest rates on other types of assets may lag behind changes in market rates. Additionally, certain assets, such as adjustable-rate loans, have features, like annual and lifetime rate caps, which restrict changes in interest rates both on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, prepayment and early withdrawal levels would likely deviate from those assumed in the table. Finally, the ability of certain borrowers to make scheduled payments on their adjustable-rate loans may decrease in the event of an interest rate increase.

**EARNINGS SIMULATION:** This model forecasts the projected change in net interest income resulting from an increase or decrease in the federal funds rate. The model assumes a one time shock of plus or minus 200 basis points or 2%. The model makes various assumptions about cash flows and reinvestments of these cash flows in the different rate environments. Generally, repayments, maturities and calls are assumed to be reinvested in like instruments and no significant change in the balance sheet mix is assumed. Actual results could differ significantly from these estimates which would produce significant differences in the calculated projected change in income. The limits stated above do not necessarily represent measures that would be taken by management in order to stabilize income results. The instruments on the balance sheet react at different speeds to various changes in interest rates as discussed under Static Gap. In addition, there are strategies available to management that may help mitigate a decline in income caused by a rapid change in interest rates.

The following table below summarizes the information from the interest rate risk measures reflecting rate sensitive assets to rate sensitive liabilities at June 30, 2011 and December 31, 2010:

|                             | June 30,<br>2011 | December 31,<br>2010 |
|-----------------------------|------------------|----------------------|
| Static 1-Yr. Cumulative Gap | 7.18%            | 3.23%                |
| Earnings Simulation:        |                  |                      |
| -200 bps vs. Stable Rate    | N/A              | N/A                  |
| +200 bps vs. Stable Rate    | 8.52%            | 0.10%                |

The interest rate sensitivity position at both June 30, 2011 and December 31, 2010 was asset sensitive in the short term. As the federal funds rate was at 0.25% on June 30, 2011 and December 31, 2010, the -200 bps scenario has been excluded. Management measures the potential impact of significant changes in interest rates on both earnings and equity. By the use of computer generated models, the potential impact of these changes has been determined to be acceptable with modest effects on net income and equity given an interest rate shock of an increase in the federal funds rate of 2.0%. We continue to monitor the interest rate sensitivity through the ALCO and use the data to make strategic decisions.



**Table of Contents****ITEM 4****CONTROLS AND PROCEDURES**

As of the end of the period covered by this quarterly report, an evaluation was carried out under the supervision and with the participation of the Corporation's management, including our Chief Executive Officer and Principal Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934) (Exchange Act). Based on their evaluation, our Chief Executive Officer and Principal Financial Officer have concluded that the Corporation's disclosure controls and procedures were effective as of the end of the period covered by this quarterly report to ensure that information required to be disclosed by the Corporation in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. There were no changes in the Corporation's internal control over financial reporting that occurred during the period covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

**PART II OTHER INFORMATION**

ITEM 1. LEGAL PROCEEDINGS None

ITEM 1A. RISK FACTORS There have been no material changes to the risk factors disclosed in Part I, Item 1A. of our Form 10-K for the year ended December 31, 2010.

ITEM 6. EXHIBITS

- EXHIBIT 3.1 Amended and Restated Articles of Incorporation of the Corporation, filed as Appendix B to the 2005 Proxy Statement, filed with the Securities and Exchange Commission (SEC) on March 24, 2006, and incorporated herein by reference.
- EXHIBIT 3.2 By-Laws of the Corporation, as amended and restated, filed as Appendix C to the 2005 Proxy Statement, filed with the SEC on March 24, 2006, and incorporated herein by reference.
- EXHIBIT 31.1 Rule 13a-14(a)/15d-14(a) Certification of the Principal Executive Officer
- EXHIBIT 31.2 Rule 13a-14(a)/15d-14(a) Certification of the Principal Financial Officer
- EXHIBIT 32 Section 1350 Certifications
- EXHIBIT 101 The following financial information from the Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2011, furnished electronically herewith, and formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Income; (iii) Consolidated Statements of Comprehensive Income; (iv) Consolidated Statements of Cash Flows; and (v) Notes to Consolidated Financial Statements, tagged as blocks of text.\*

\* In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

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**SIGNATURES**

Pursuant to the requirements 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.

CNB FINANCIAL CORPORATION  
(Registrant)

DATE: August 5, 2011

/s/ Joseph B. Bower, Jr.  
Joseph B. Bower, Jr.  
President and Director  
(Principal Executive Officer)

DATE: August 5, 2011

/s/ Charles R. Guarino  
Charles R. Guarino  
Treasurer  
(Principal Financial Officer)