

FIDELITY D & D BANCORP INC
Form 10-Q
November 09, 2010

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

FORM 10-Q

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

For the quarterly period ended September 30, 2010

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: 333-90273

FIDELITY D & D BANCORP, INC.

STATE OF INCORPORATION: IRS EMPLOYER IDENTIFICATION NO:
PENNSYLVANIA 23-3017653

Address of principal executive offices:
BLAKELY & DRINKER ST.
DUNMORE, PENNSYLVANIA 18512

TELEPHONE:
570-342-8281

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 subjected to such filing requirements for the past 90 days. YES NO

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

YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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
Non-accelerated filer

Accelerated filer
Smaller reporting company

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(Do not check if a 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 outstanding shares of Common Stock of Fidelity D & D Bancorp, Inc. on October 31, 2010, the latest practicable date, was 2,162,063 shares.

FIDELITY D & D BANCORP, INC.

Form 10-Q September 30, 2010

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PART I – Financial Information

Item 1: Financial Statements

FIDELITY D & D BANCORP, INC. AND SUBSIDIARY
Consolidated Balance Sheets

(Unaudited)

	September 30, 2010	December 31, 2009
Assets:		
Cash and due from banks	\$ 10,489,922	\$ 8,173,199
Interest-bearing deposits with financial institutions	37,081,253	154,755
Total cash and cash equivalents	47,571,175	8,327,954
Available-for-sale securities	86,720,420	75,821,292
Held-to-maturity securities (fair value \$585,337 in 2010; \$765,195 in 2009)	535,261	708,706
Federal Home Loan Bank Stock	4,781,100	4,781,100
Loans and leases, net (allowance for loan losses of \$7,484,253 in 2010; \$7,573,603 in 2009)	414,185,347	423,124,054
Loans held-for-sale (fair value \$1,037,337 in 2010; \$1,233,345 in 2009)	1,019,000	1,221,365
Bank premises and equipment, net	14,649,763	15,361,810
Cash surrender value of bank owned life insurance	9,347,707	9,117,156
Accrued interest receivable	2,233,322	2,250,855
Foreclosed assets held-for-sale	1,350,692	887,397
Other assets	14,204,811	14,415,582
Total assets	\$ 596,598,598	\$ 556,017,271
Liabilities:		
Deposits:		
Interest-bearing	\$ 409,063,486	\$ 388,103,880
Non-interest-bearing	81,819,441	70,890,578
Total deposits	490,882,927	458,994,458
Accrued interest payable and other liabilities	3,235,939	2,815,159
Short-term borrowings	21,804,259	16,533,107
Long-term debt	32,000,000	32,000,000
Total liabilities	547,923,125	510,342,724
Shareholders' equity:		
Preferred stock authorized 5,000,000 shares with no par value; none issued	-	-
Capital stock, no par value (10,000,000 shares authorized; shares issued and outstanding; 2,163,618 in 2010; and 2,105,860 in 2009)	20,793,445	19,982,677
Retained earnings	34,919,228	34,886,265
Accumulated other comprehensive loss	(7,037,200)	(9,194,395)
Total shareholders' equity	48,675,473	45,674,547
Total liabilities and shareholders' equity	\$ 596,598,598	\$ 556,017,271

See notes to unaudited consolidated financial statements

FIDELITY D & D BANCORP, INC. AND SUBSIDIARY
Consolidated Statements of Income
(Unaudited)

	Three months ended		Nine months ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
Interest income:				
Loans and leases:				
Taxable	\$ 6,056,924	\$ 6,435,487	\$ 18,141,108	\$ 19,353,099
Nontaxable	157,015	110,566	457,166	338,828
Interest-bearing deposits with financial institutions	21,970	89	38,288	537
Investment securities:				
U.S. government agency and corporations	401,070	534,629	1,360,080	1,852,457
States and political subdivisions (non-taxable)	261,005	318,299	770,415	787,208
Other securities	55,607	50,994	184,578	393,502
Federal funds sold	109	3,422	13,549	10,781
Total interest income	6,953,700	7,453,486	20,965,184	22,736,412
Interest expense:				
Deposits	1,244,438	1,949,402	3,958,215	6,279,307
Securities sold under repurchase agreements	6,464	5,872	76,654	22,427
Other short-term borrowings and other	130	1,446	763	27,991
Long-term debt	429,896	1,075,934	1,280,565	2,420,466
Total interest expense	1,680,928	3,032,654	5,316,197	8,750,191
Net interest income	5,272,772	4,420,832	15,648,987	13,986,221
Provision for loan losses	375,000	3,125,000	1,250,000	3,850,000
Net interest income after provision for loan losses	4,897,772	1,295,832	14,398,987	10,136,221
Other (loss) income:				
Service charges on deposit accounts	675,598	676,107	1,964,512	1,956,755
Fees and other service charges	602,570	428,049	1,620,579	1,407,538
Gain (loss) on sale or disposal of:				
Loans	211,019	139,451	439,735	957,777
Premises and equipment	(7,359)	(34,617)	(23,530)	(41,241)
Foreclosed assets held-for-sale	36,135	7,780	57,550	33,667
Write-down of foreclosed assets held-for-sale	(39,700)	(77,560)	(39,700)	(77,560)

Impairment losses on investment securities:

Other-than-temporary impairment on investment securities	(2,166,122)	(6,468,236)	(4,431,359)	(6,794,331)
Non-credit related losses on investment securities not expected to be sold (recognized in other comprehensive income/(loss))	417,448	4,036,470	1,927,763	4,036,470
Net impairment losses on investment securities recognized in earnings	(1,748,674)	(2,431,766)	(2,503,596)	(2,757,861)
Total other (loss) income	(270,411)	(1,292,556)	1,515,550	1,479,075

Other expenses:

Salaries and employee benefits	2,167,403	2,502,818	7,169,335	7,495,167
Premises and equipment	808,204	874,028	2,549,466	2,685,343
Advertising	110,292	117,897	418,095	396,290
Other	1,231,712	1,614,552	3,979,319	3,933,271
Total other expenses	4,317,611	5,109,295	14,116,215	14,510,071

Income (loss) before income taxes	309,750	(5,106,019)	1,798,322	(2,894,775)
(Credit) provision for income taxes	(45,193)	(1,895,339)	168,527	(1,421,306)
Net income (loss)	\$ 354,943	\$ (3,210,680)	\$ 1,629,795	\$ (1,473,469)

Per share data:

Net income (loss) - basic	\$ (0.44)	\$ (1.55)	\$ 0.16	\$ (0.71)
Net income (loss) - diluted	\$ (0.44)	\$ (1.55)	\$ 0.16	\$ (0.71)
Dividends	\$ 0.25	\$ 0.25	\$ 0.75	\$ 0.75

See notes to unaudited consolidated financial statements

FIDELITY D & D BANCORP, INC. AND SUBSIDIARY
 Consolidated Statements of Changes in Shareholders' Equity
 For the nine months ended September 30, 2010 and 2009
 (Unaudited)

	Capital stock		Treasury stock		Retained earnings	Accumulated other comprehensive loss	Total
	Shares	Amount	Shares	Amount			
Balance, December 31, 2008	2,075,182	\$ 19,410,306	(12,255)	\$ (351,665)	\$ 38,126,250	\$ (8,224,240)	\$ 48,960,651
Cumulative effect of change in accounting principle					350,720	(350,720)	-
Total comprehensive income:							
Net loss					(1,473,469)		(1,473,469)
Change in net unrealized holding losses on available-for-sale securities, net of reclassification adjustment and net of tax adjustments of \$2,499,696						4,852,351	4,852,351
Non-credit related impairment losses on investment securities not expected to be sold, net of tax adjustments of \$1,372,400						(2,664,070)	(2,664,070)
Change in cash flow hedge intrinsic value						(560,956)	(560,956)
Comprehensive income							153,856
Issuance of common stock through Employee Stock Purchase Plan	1,701	40,569					40,569
Purchase of treasury stock			(2,500)	(56,505)			(56,505)

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Issuance of common stock through Dividend Reinvestment Plan	16,430	320,269	14,755	408,170	(112,329)		616,110
Stock-based compensation expense		4,508					4,508
Cash dividends declared					(1,554,842)		(1,554,842)
Balance, September 30, 2009	2,093,313	\$ 19,775,652	- \$	- \$	\$ 35,336,330	\$ (6,947,635)	\$ 48,164,347
Balance, December 31, 2009	2,105,860	\$ 19,982,677	- \$	- \$	\$ 34,886,265	\$ (9,194,395)	\$ 45,674,547
Total comprehensive income:							
Net income					1,629,795		1,629,795
Change in net unrealized holding losses on available-for-sale securities, net of reclassification adjustment and net of tax adjustments of \$1,766,721						3,429,518	3,429,518
Non-credit related impairment losses on investment securities not expected to be sold, net of tax adjustments of \$655,440						(1,272,323)	(1,272,323)
Comprehensive income							3,786,990
Issuance of common stock through Employee Stock Purchase Plan	4,754	67,367					67,367
Issuance of common stock through Dividend							

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Reinvestment Plan	53,004	735,916					735,916
Stock-based compensation expense		7,485					7,485
Cash dividends declared				(1,596,832)			(1,596,832)
Balance, September 30, 2010	2,163,618	\$ 20,793,445	- \$	- \$	\$ 34,919,228	\$ (7,037,200)	\$ 48,675,473

See notes to unaudited consolidated financial statements

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FIDELITY DEPOSIT & DISCOUNT BANCORP, INC. AND SUBSIDIARY
Consolidated Statements of Cash Flows
(Unaudited)

	Nine months ended September 30,	
	2010	2009
Cash flows from operating activities:		
Net income (loss)	\$ 1,629,795	\$ (1,473,469)
Adjustments to reconcile net income (loss) to cash flows from operating activities:		
Depreciation, amortization and accretion	1,484,101	1,130,120
Provision for loan losses	1,250,000	3,850,000
Deferred income tax benefit	(703,673)	(1,211,999)
Stock-based compensation expense	7,485	4,508
Loss from investment in limited partnership	-	40,961
Proceeds from sale of loans held-for-sale	37,806,323	90,195,545
Originations of loans held-for-sale	(33,780,457)	(79,702,670)
Write-down of foreclosed assets held-for-sale	39,700	77,560
Increase in cash surrender value of life insurance	(230,551)	(230,777)
Net gain from sales of loans	(439,735)	(957,777)
Net gain from sales of foreclosed assets held-for-sale	(57,550)	(33,667)
Loss from disposal of equipment	23,530	41,241
Other-than-temporary impairment on securities	2,503,596	2,757,861
Change in:		
Accrued interest receivable	(74,406)	(285,893)
Other assets	(67,783)	(1,262,594)
Accrued interest payable and other liabilities	457,725	22,564
Net cash provided by operating activities	9,848,100	12,961,514
Cash flows from investing activities:		
Held-to-maturity securities:		
Proceeds from maturities, calls and principal pay-downs	173,443	169,017
Available-for-sale securities:		
Proceeds from maturities, calls and principal pay-downs	29,266,139	30,396,495
Purchases	(39,288,074)	(28,383,313)
Net decrease (increase) in loans and leases	2,930,070	(85,653)
Acquisition of bank premises and equipment	(623,134)	(808,304)
Proceeds from sale of foreclosed assets held-for-sale	570,605	510,554
Net cash (used in) provided by investing activities	(6,970,951)	1,798,796
Cash flows from financing activities:		
Net increase in deposits	31,888,469	43,946,639
Net increase (decrease) in short-term borrowings	5,271,152	(32,891,247)
Repayments of long-term debt	-	(20,000,000)
Purchase of treasury stock	-	(56,505)
Proceeds from Employee Stock Purchase Plan participants	67,367	40,569
Dividends paid, net of dividends reinvested	(1,067,807)	(938,732)

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Proceeds from Dividend Reinvestment Plan participants	206,891	-
Net cash provided by (used in) financing activities	36,366,072	(9,899,276)
Net increase in cash and cash equivalents	39,243,221	4,861,034
Cash and cash equivalents, beginning	8,327,954	12,771,147
Cash and cash equivalents, ending	\$ 47,571,175	\$ 17,632,181

See notes to unaudited consolidated financial statements

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FIDELITY D & D BANCORP, INC.

Notes to Consolidated Financial Statements
(Unaudited)

1. Nature of operations and critical accounting policies

Nature of operations

Fidelity Deposit and Discount Bank (the Bank) is a commercial bank chartered in the Commonwealth of Pennsylvania and a wholly-owned subsidiary of Fidelity D & D Bancorp, Inc. (the Company or collectively, the Company). Having commenced operations in 1903, the Bank is committed to provide superior customer service, while offering a full range of banking products and financial and trust services to both our consumer and commercial customers from our main office located in Dunmore and other branches located throughout Lackawanna and Luzerne counties.

Principles of consolidation

The accompanying unaudited consolidated financial statements of the Company and the Bank have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to this Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and footnote disclosures required by GAAP for complete financial statements. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the financial condition and results of operations for the periods have been included. All significant inter-company balances and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates. For additional information and disclosures required under GAAP, refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

Management is responsible for the fairness, integrity and objectivity of the unaudited financial statements included in this report. Management prepared the unaudited financial statements in accordance with GAAP. In meeting its responsibility for the financial statements, management depends on the Company's accounting systems and related internal controls. These systems and controls are designed to provide reasonable but not absolute assurance that the financial records accurately reflect the transactions of the Company, the Company's assets are safeguarded and that the financial statements present fairly the financial condition and results of operations of the Company.

In the opinion of management, the consolidated balance sheets as of September 30, 2010 and December 31, 2009 and the related consolidated statements of income for the three- and nine-month periods ended September 30, 2010 and 2009 and changes in shareholders' equity and cash flows for the nine months ended September 30, 2010 and 2009 present fairly the financial condition and results of operations of the Company. All material adjustments required for a fair presentation have been made. These adjustments are of a normal recurring nature.

This Quarterly Report on Form 10-Q should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2009, and the notes included therein, included within the Company's Annual Report filed on Form 10-K.

Critical accounting policies

The presentation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect many of the reported amounts and disclosures. Actual results could differ from these estimates.

A material estimate that is particularly susceptible to significant change relates to the determination of the allowance for loan losses. Management believes that the allowance for loan losses at September 30, 2010 is adequate and reasonable. Given the subjective nature of identifying and valuing loan losses, it is likely that well-informed individuals could make different assumptions, and could, therefore calculate a materially different allowance value. While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in the future. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize adjustments to the allowance based on their judgment of information available to them at the time of their examination.

Another material estimate is the calculation of fair values of the Company's investment securities. Except for the Company's investment in corporate bonds, consisting of pooled trust preferred securities, fair values of the other investment securities are determined by prices provided by a third-party vendor who is a provider of financial market data, analytics and related services to financial institutions. For the pooled trust preferred securities, management is unable to obtain readily attainable and realistic pricing from market traders due to lack of active market participants and therefore management has determined the market for these securities to be inactive. In order to determine the fair value of the pooled trust preferred securities, management relied on the use of an income valuation approach (present value technique) that maximizes the use of observable inputs and minimizes the use of unobservable inputs, the results of which are more representative of fair value than the market approach valuation technique used for the other investment securities.

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Based on experience, management is aware that estimated fair values of investment securities tend to vary among valuation services. Accordingly, when selling investment securities, price quotes from more than one source may be obtained. The majority of the Company's investment securities are classified as available-for-sale (AFS). AFS securities are carried at fair value on the consolidated balance sheet, with unrealized gains and losses, net of income tax, reported separately within shareholders' equity through accumulated other comprehensive income (loss).

The fair value of residential mortgage loans, classified as held-for-sale (HFS), is obtained from the Federal National Mortgage Association (FNMA) or the Federal Home Loan Bank (FHLB). Generally, the market to which the Company sells mortgages it originates for sale is restricted and price quotes from other sources are not typically obtained. On occasion, the Company may transfer loans from the loan and lease portfolio to loans HFS. Under these rare circumstances, pricing may be obtained from other entities and the loans are transferred at the lower of cost or market value and simultaneously sold. For a further discussion on the accounting treatment of loans HFS, see the section entitled "Loans held-for-sale," contained within management's discussion and analysis.

For purposes of reporting cash flows, cash and cash equivalents includes cash on hand, amounts due from banks and interest-bearing deposits with financial institutions. For the nine months ended September 30, 2010 and 2009, the Company paid interest of \$5,365,000 and \$9,140,000, respectively. The Company paid income taxes during the first nine months of 2010 of \$575,000, and \$675,000 for the nine months ended September 30, 2009. Transfers from loans to foreclosed assets held-for-sale amounted to \$1,053,000 and \$470,000 during the first nine months of 2010 and 2009, respectively. Transfers from loans to loans HFS amounted to \$3,706,000 and \$11,140,000 during the nine months ended 2010 and 2009, respectively. Expenditures for construction in process, a component of other assets in the consolidated balance sheets, are included in acquisition of bank premises and equipment.

2. New Accounting Pronouncements

During the first quarter of 2010, the Company adopted the new accounting guidance related to the transfers and servicing of financial assets. The standard eliminates the concept of qualifying special purpose entities, provides guidance as to when a portion of a transferred financial asset should be evaluated for sale accounting, provides additional guidance with regard to accounting for transfers of financial assets and requires additional disclosures. The adoption of the new accounting guidance did not have a material impact on the Company's consolidated financial statements.

During the first quarter of 2010, the Company adopted the amended accounting guidance related to fair value measurements which entails new disclosures and clarifies disclosure requirements about fair value measurement as set forth in previous guidance. The objective is to improve these disclosures and, thus, increase the transparency in financial reporting. Specifically, an entity is required to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers; and in the reconciliation for fair value measurements using significant unobservable inputs, a reporting entity should present separately information about purchases, sales, issuances, and settlements. The amended guidance also clarifies the requirements of the following disclosures: for purposes of reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities; and a reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and non-recurring fair value measurements. The new guidance became effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures will become effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years.

In July 2010, the FASB issued new guidance on disclosures about the credit quality of financing receivables and the allowance for credit losses. The new disclosure guidance will significantly expand the existing requirements for greater transparency into a company's exposure to credit losses from lending type arrangements. The objectives of the

expanded disclosures are to provide information that will enable readers of financial statements to understand the nature of credit risk in a company's financing receivables, how that risk is analyzed in determining the related allowance for credit losses and changes to the allowance during the reporting period. The new guidance applies to all companies. The extensive new disclosures of information as of the end of a reporting period will become effective for both interim and annual reporting periods ending after December 15, 2010 for public companies. Specific items regarding activity that occurred before the issuance of the new guidance, such as the allowance roll forward and modification disclosures will be required for periods beginning after December 15, 2010 for public companies.

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3. Investment securities

The amortized cost and fair value of investment securities at September 30, 2010 and December 31, 2009 are summarized as follows (dollars in thousands):

	Amortized cost	September 30, 2010 Gross unrealized gains	Gross unrealized losses	Fair value
Held-to-maturity securities:				
MBS - GSE residential	\$ 535	\$ 50	\$ -	\$ 585
Available-for-sale securities:				
Agency - GSE	\$ 17,311	\$ 193	\$ 81	\$ 17,423
Obligations of states and political subdivisions	23,248	1,167	-	24,415
Corporate bonds:				
Pooled trust preferred securities	16,360	-	12,634	3,726
MBS - GSE residential	40,142	680	105	40,717
Total debt securities	97,061	2,040	12,820	86,281
Equity securities - financial services	322	117	-	439
Total available-for-sale securities	\$ 97,383	\$ 2,157	\$ 12,820	\$ 86,720

	Amortized cost	December 31, 2009 Gross unrealized gains	Gross unrealized losses	Fair value
Held-to-maturity securities:				
MBS - GSE residential	\$ 709	\$ 56	\$ -	\$ 765
Available-for-sale securities:				
Agency - GSE	\$ 34,205	\$ 4	\$ 1,077	\$ 33,132
Obligations of states and political subdivisions	23,013	394	137	23,270
Corporate bonds:				
Pooled trust preferred securities	18,794	-	13,552	5,242
MBS - GSE residential	13,418	401	71	13,748
Total debt securities	89,430	799	14,837	75,392
Equity securities - financial services	322	121	14	429
Total available-for-sale securities	\$ 89,752	\$ 920	\$ 14,851	\$ 75,821

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The amortized cost and fair value of debt securities at September 30, 2010 by contractual maturity are summarized below (dollars in thousands):

	Amortized cost	Market value
Held-to-maturity securities:		
MBS - GSE residential	\$ 535	\$ 585
Available-for-sale securities:		
Debt securities:		
Due in one year or less	\$ 6,239	\$ 6,156
Due after one year through five years	1,000	1,001
Due after five years through ten years	4,151	4,228
Due after ten years	45,529	34,179
Total debt securities	56,919	45,564
MBS - GSE residential	40,142	40,717
Total available-for-sale debt securities	\$ 97,061	\$ 86,281

Expected maturities will differ from contractual maturities because issuers and borrowers may have the right to call or repay obligations with or without call or prepayment penalty. Federal agency and municipal securities are included based on their original stated maturity. Mortgage-backed securities, which are based on weighted-average lives and subject to monthly principal pay-downs, are listed in total.

The following tables present the fair value and gross unrealized losses of investment securities aggregated by investment type, the length of time and the number of securities that have been in a continuous unrealized loss position as of September 30, 2010 and December 31, 2009 (dollars in thousands):

	Less than 12 months		September 30, 2010 More than 12 months		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Agency - GSE	\$ -	\$ -	\$ 6,006	\$ 81	\$ 6,006	\$ 81
Corporate bonds:						
Pooled trust preferred securities	-	-	3,726	12,634	3,726	12,634
MBS - GSE residential	19,884	105	-	-	19,884	105
Total temporarily impaired securities	\$ 19,884	\$ 105	\$ 9,732	\$ 12,715	\$ 29,616	\$ 12,820
Number of securities	9		14		23	

	Less than 12 months		December 31, 2009 More than 12 months		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Agency - GSE	\$ 21,090	\$ 291	\$ 5,038	\$ 786	\$ 26,128	\$ 1,077
Obligations of states and political subdivisions	3,534	115	2,600	22	6,134	137
Corporate bonds:						

Pooled trust preferred securities	-	-	5,242	13,552	5,242	13,552
MBS - GSE residential	5,055	71	-	-	5,055	71
Total debt securities	29,679	477	12,880	14,360	42,559	14,837
Equity securities - financial services	114	10	46	4	160	14
Total temporarily impaired securities	\$ 29,793	\$ 487	\$ 12,926	\$ 14,364	\$ 42,719	\$ 14,851
Number of securities	23		17		40	

Management conducts a formal review of investment securities on a quarterly basis for the presence of other-than-temporary impairment (OTTI). The accounting guidance related to OTTI requires the Company to assess whether OTTI is present when the fair value of a debt security is less than its amortized cost as of the balance sheet date. Under these circumstances, OTTI is considered to have occurred if: (1) the entity has intent to sell the security; (2) more likely than not the entity will be required to sell the security before recovery of its amortized cost basis; or (3) the present value of expected cash flows is not sufficient to recover the entire amortized cost.

The accounting guidance requires that credit-related OTTI be recognized in earnings while non-credit-related OTTI on securities not expected to be sold be recognized in other comprehensive income (OCI). Non-credit-related OTTI is based on other factors effecting market conditions, including illiquidity. The presentation of OTTI is made in the consolidated statements of income on a gross basis with an offset for the amount of non-credit-related OTTI recognized in OCI.

The Company's OTTI evaluation process also follows the guidance set forth in topics related to debt and equity securities. The guidance set forth in these pronouncements requires the Company to take into consideration current market conditions, fair value in relationship to cost, extent and nature of changes in fair value, issuer rating changes and trends, volatility of earnings, current analysts' evaluations, all available information relevant to the collectability of debt securities, the ability and intent to hold investments until a recovery of fair value, which may be maturity, and other factors when evaluating for the existence of OTTI. This guidance also eliminates the requirement that a holder's best estimate of cash flows is based upon those that a market participant would use. Instead, the guidance requires that OTTI be recognized as a realized loss through earnings when there has been an adverse change in the holder's expected cash flows such that the full amount (principal and interest) will probably not be received. This requirement is consistent with the impairment model in the guidance for accounting for debt and equity securities.

For all security types discussed below, at September 30, 2010 the Company applied the criteria provided in the recognition and presentation of OTTI guidance. That is, management has no intent to sell the securities and no conditions were identified by management that more likely than not would require the Company to sell the securities before recovery of their amortized cost basis. The results indicated there was no presence of OTTI for the Company's portfolios of Agency – Government Sponsored Enterprise (GSE), Mortgage-backed securities (MBS) – GSE residential and Obligations of states and political subdivisions.

Agency - GSE and MBS - GSE residential

Agency – GSE and MBS – GSE residential securities consist of medium and long-term notes issued by Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA), Federal Home Loan Bank (FHLB) and Government National Mortgage Association (GNMA). These securities have interest rates that are largely fixed-rate issues, have varying mid- to long-term maturity dates and have contractual cash flows guaranteed by the U.S. government or agencies of the U.S. government.

Obligations of states and political subdivisions

The municipal securities are bank qualified, general obligation bonds rated as investment grade by various credit rating agencies and have fixed rates of interest with mid- to long-term maturities. Fair values of these securities are highly driven by interest rates. Management performs ongoing credit quality reviews on these issues.

In all of the above security types, the decline in fair value is attributable to changes in interest rates and not credit quality. Consequently, no OTTI is considered necessary for these securities at September 30, 2010.

Pooled trust preferred securities

A Pooled Trust Preferred Collateralized Debt Obligation (CDO) is a type of investment security collateralized by trust preferred securities (TPS) issued by banks, insurance companies and real estate investment trusts (REITs). The primary collateral type is a TPS issued by a bank. A TPS is a hybrid security with both debt and equity characteristics such as the ability to voluntarily defer interest payments for up to 20 consecutive quarters. A TPS is considered a junior security in the capital structure of the issuer.

There are various tranches or investment classes issued by the CDO with the most senior tranche having the lowest yield but the most protection from credit losses compared to other tranches that are subordinate. Losses are generally allocated from the lowest tranche with the equity component holding the most risk and then subordinate tranches in reverse order up to the senior tranche. The allocation of losses is defined in the indenture when the CDO

was formed.

Unrealized losses in the pooled trust preferred securities (PreTSLs) are caused mainly by the following factors: (1) collateral deterioration due to bank failures and credit concerns across the banking sector; (2) widening of credit spreads and (3) illiquidity in the market. The Company's review of these securities, in accordance with the previous discussion, determined that in 2010, credit-related OTTI be recorded on six holdings of these securities all of which are in the AFS securities portfolio.

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The following table summarizes the amount of OTTI recognized in earnings, by security during the periods indicated (dollars in thousands):

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Pooled trust preferred securities:				
PreTSL V, Mezzanine	\$ 122	\$ -	\$ 122	\$ -
PreTSL VII, Mezzanine	-	325	86	651
PreTSL IX, B1, B3	-	690	-	690
PreTSL XI, B3	-	-	60	-
PreTSL XV, B1	285	154	285	154
PreTSL XVI, C	681	756	1,290	756
PreTSL XVII, C	661	-	661	-
PreTSL XXV, C1	-	507	-	507
Total	\$ 1,749	\$ 2,432	\$ 2,504	\$ 2,758

The following table is a tabular roll-forward of the cumulative amount of credit-related OTTI recognized in earnings (dollars in thousands):

	Inception to		
	September 30, 2010		
	HTM	AFS	Total
Balance of credit-related OTTI - December 31, 2009	\$ -	\$ (3,198)	\$ (3,198)
Additions for credit-related OTTI not previously recognized	-	(843)	(843)
Additional credit-related OTTI previously recognized when there is no intent to sell before recovery of amortized cost basis	-	(1,661)	(1,661)
Ending balance of credit-related OTTI	\$ -	\$ (5,702)	\$ (5,702)

To determine the ending balance of credit-related OTTI, the Company uses discounted present value cash flow analysis and compares the results with the bond's face value. The analysis considered the following assumptions: the discount rate which equated to the discount margin for each tranche (credit spread) at the time of purchase which was then added to the appropriate three-month Libor forward rate obtained from the forward Libor curve; historical average default rates obtained from the FDIC for U.S. Banks and Thrifts for the period spanning 1988 to 1991 increased by a factor of three and rolled forward to project a rate of default of approximately one-third; the default rate was reduced by the actual deferrals/defaults experienced in all preferred term securities from 2008 through 2009; the remaining estimated default rate was then stratified with higher default rates occurring in the beginning of 2010 regressing to normal in 2011, with an estimated 15% recovery by way of a two year lag; and no prepayments of principal.

Two of the Company's initial mezzanine holdings (PreTSLs IV and V) are now senior tranches and the remaining holdings are mezzanine tranches. As of September 30, 2010, none of the pooled trust preferred securities were investment grade. At the time of initial issue, the subordination in the Company's tranches ranged in size from approximately 8.0% to 25.9% of the total principal amount of the respective securities and no more than 5% of any pooled trust preferred security consisted of a security issued by any one bank and 4% for insurance companies. As of September 30, 2010, management estimates the subordination in the Company's tranches ranging from 0% to 19.2% of the current performing collateral. During the nine months of 2010, PreTSL IX with a book value of \$2.8 million and

corresponding fair value of \$1.1 million, and PreTSL XVII with a book value of \$353,000 and no corresponding fair value were placed on non-accrual status.

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The following table is the composition of the Company's non-accrual PreTSL securities as of the period indicated (dollars in thousands):

Deal	Class	September 30, 2010		December 31, 2009	
		Book value	Fair value	Book value	Fair value
PreTSL VII	Mezzanine	\$ 332	\$ 154	\$ 432	\$ 219
PreTSL IX	B-1,B-3	2,765	1,119	-	-
PreTSL XV	B-1	1,075	125	1,359	297
PreTSL XVI	C	-	-	1,290	65
PreTSL XVII	C	353	-	-	-
PreTSL XXV	C-1	507	-	507	2
		\$ 5,032	\$ 1,398	\$ 3,588	\$ 583

The securities included in the above table, have experienced impairment of principal, and interest was "paid-in-kind". On a quarterly basis, each of the other issues will be evaluated for the presence of these two conditions and placed on non-accrual status if necessary.

The following table provides additional information with respect to the Company's pooled trust preferred securities as of September 30, 2010 (dollars in thousands):

Deal	Class	Book value	Fair value	Unrealized loss	Moody's ratings	Current number of banks / insurance companies		Actual deferrals and defaults as a % of current collateral	Actual deferrals and defaults as a % of current collateral	Excess subordination	Effective subordination**
PreTSL IV	Mezzanine	\$ 610	\$ 421	\$ (189)	CCC / Ca	6 / -	18,000	27.1	9,889	19.2	35.0
PreTSL V	Mezzanine	151	151	-	Ba3 / D	3 / -	28,950	100.0	None	N/A	N/A
PreTSL VII	Mezzanine	332	154	(178)	Ca / C	19 / -	160,000	70.5	None	N/A	N/A
PreTSL IX	B-1,B-3	2,766	1,118	(1,648)	Ca / C	49 / -	131,510	29.2	None	N/A	N/A
PreTSL XI	B-3	2,341	769	(1,572)	Ca / C	65 / -	142,780	23.7	None	N/A	6.9
PreTSL XV	B-1	1,075	125	(950)	Ca / C	63 / 9	209,450	35.0	None	N/A	N/A
PreTSL XVI	C	-	-	-	Ca / C	49 / 7	251,190	43.6	None	N/A	N/A
PreTSL XVII	C	353	-	(353)	Ca / C	51 / 6	187,670	39.6	None	N/A	N/A
PreTSL XVIII	C	1,017	64	(953)	Ca / C	66 / 14	158,140	23.4	None	N/A	4.8
PreTSL XIX	C	2,566	180	(2,386)	C / C	60 / 14	172,400	24.6	None	N/A	5.1
	B-1	2,245	194	(2,051)			374,800	35.7	None	N/A	10.0

PreTSL XXIV					Caa3 / CC	80 / 13					
PreTSL XXV	C-1	507	-	(507)	C / C	64 / 9	285,600	32.6	None	N/A	0.3
PreTSL XXVII	B	2,397	550	(1,847)	Ca / CC	42 / 7	95,800	29.4	None	N/A	19.9
		\$ 16,360	\$ 3,726	\$ (12,634)							

* Excess subordination represents the excess (if any) of the amount of performing collateral over the given class of bonds.

**Effective subordination represents the estimated percentage of the performing collateral that would need to defer or default at the next payment in order to trigger a loss of principal or interest. This differs from excess subordination in that it considers the effect of excess interest earned on the performing collateral.

For a further discussion on the fair value determination of the Company's investment in pooled trust preferred securities, see "Investment securities" under the caption "Comparison of financial condition at September 30, 2010 and December 31, 2009" of Part 1, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations"; below.

4. Earnings (loss) per share

Basic earnings (loss) per share (EPS) is computed by dividing income available to common shareholders by the weighted-average number of common stock outstanding for the period. Diluted EPS is computed in the same manner as basic EPS but reflects the potential dilution that could occur if stock options to issue additional common stock were exercised, which would then result in additional stock outstanding to share in or dilute the earnings of the Company. The Company maintains two share-based compensation plans that may generate additional potential dilutive common shares. Generally, dilution would occur if Company-issued stock options were exercised and converted into common stock.

In the computation of diluted EPS, the Company uses the treasury stock method to determine the dilutive effect of its granted but unexercised stock options. Under the treasury stock method, the assumed proceeds received from shares issued, in a hypothetical stock option exercise, are assumed to be used to purchase treasury stock. There were no potentially dilutive shares outstanding in either period because the average share market price of the Company's common stock during the nine months ended September 30, 2010 and 2009 was below the strike prices of all options granted. For a further discussion on the Company's stock option plans, see Note 5, "Stock plans," below.

The following table illustrates the data used in computing basic EPS and a reconciliation to derive at the components of diluted EPS for the periods indicated:

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Basic EPS:				
Net income (loss) available to common shareholders	\$ 354,943	\$ (3,210,680)	\$ 1,629,795	\$ (1,473,469)
Weighted-average common shares outstanding	2,151,880	2,085,089	2,132,974	2,075,181
Basic EPS	\$ 0.16	\$ (1.55)	\$ 0.76	\$ (0.71)
Diluted EPS:				
Net income (loss) available to common shareholders	\$ 354,943	\$ (3,210,680)	\$ 1,629,795	\$ (1,473,469)
Weighted-average common shares outstanding	2,151,880	2,085,089	2,132,974	2,075,181
Potentially dilutive common shares	-	-	-	-
Weighted-average common shares and dilutive potential shares	2,151,880	2,085,089	2,132,974	2,075,181
Diluted EPS	\$ 0.16	\$ (1.55)	\$ 0.76	\$ (0.71)

5. Stock plans

The Company has two stock-based compensation plans (the stock option plans) and applies the fair value method of accounting for stock-based compensation provided under the current accounting guidance. The guidelines require the cost of share-based payment transactions (including those with employees and non-employees) be recognized in the financial statements. The stock option plans were shareholder-approved and permit the grant of share-based compensation awards to its directors, key officers and certain other employees. The Company believes that the stock option plans better align the interest of its directors, key officers and employees with the interest of its shareholders. The Company further believes that the granting of share-based awards is necessary to retain the knowledge base, continuity and expertise of its directors, key officers and employees. In the stock option plans, directors, key officers and certain other employees are eligible to be awarded stock options to purchase the Company's common stock at the fair market value on the date of grant.

The Company established the 2000 Independent Directors Stock Option Plan and has reserved 55,000 shares of its un-issued capital stock for issuance under the plan. No stock options were awarded during the nine months ended September 30, 2010 and 2009. As of September 30, 2010, there were 21,050 unexercised stock options outstanding under this plan.

The Company also established the 2000 Stock Incentive Plan and has reserved 55,000 shares of its un-issued capital stock for issuance under the plan. There were no options awarded during the nine months ended September 30, 2010 and 2009. As of September 30, 2010, there were 6,810 unexercised stock options outstanding under this plan.

Since no awards were vested in either of the stock option plans during the nine months ended September 30, 2010 and 2009, there was no stock-based compensation expense recognized related to either of the stock option plans.

In addition to the two stock option plans, the Company established the 2002 Employee Stock Purchase Plan (the ESPP) and reserved 110,000 shares of its un-issued capital stock for issuance. The plan was designed to promote broad-based employee ownership of the Company's stock and to motivate employees to improve job performance and enhance the financial results of the Company. Under the ESPP, employees use automatic payroll withholdings to purchase the Company's capital stock at a discounted price based on the fair market value of the capital stock as measured on either the commencement date or termination date. As of September 30, 2010, 17,025 shares have been

issued under the ESPP. The ESPP is considered a compensatory plan and as such, is required to comply with the provisions of authoritative accounting guidance. The Company recognizes compensation expense on its ESPP on the date the shares are purchased. For the nine months ended September 30, 2010 and 2009, compensation expense related to the ESPP approximated \$7,000 and \$5,000, respectively, and is included as a component of salaries and employee benefits in the consolidated statements of income.

6. Fair value measurements

The accounting guidelines established a framework for measuring fair value and enhancing disclosures about fair value measurements. The guidelines of fair value reporting instituted a valuation hierarchy for disclosure of the inputs used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 inputs are quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument;

Level 3 inputs are unobservable inputs based on our own assumptions to measure assets and liabilities at fair value. Level 3 pricing for securities may also include unobservable inputs based upon broker-traded transactions. A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The Company uses fair value to measure certain assets and, if necessary, liabilities on a recurring basis when fair value is the primary measure for accounting. Thus, the Company uses fair value for AFS securities. Fair value is used on a non-recurring basis to measure certain assets when adjusting carrying values to market values, such as impaired loans.

The following table illustrates the financial instruments measured at fair value on a recurring basis segregated by hierarchy fair value levels as of September 30, 2010 and December 31, 2009 (dollars in thousands):

Fair value measurements at September 30, 2010:				
Assets:	Total carrying value at September 30, 2010	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Available-for-sale securities:				
Agency - GSE	\$ 17,423	\$ -	\$ 17,423	\$ -
Obligations of states and political subdivisions	24,415	-	24,415	-
Corporate bonds:				
Pooled trust preferred securities	3,726	-	-	3,726
MBS - GSE residential	40,717	-	40,717	-
Equity securities - financial services	439	439	-	-
Total available-for-sale securities	\$ 86,720	\$ 439	\$ 82,555	\$ 3,726

Fair value measurements at December 31, 2009:				
Assets:	Total carrying value at December 31, 2009	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Available-for-sale securities:				
Agency - GSE	\$ 33,132	\$ -	\$ 33,132	\$ -
Obligations of states and political subdivisions	23,270	-	23,270	-
Corporate bonds:				
Pooled trust preferred securities	5,242	-	-	5,242
MBS - GSE residential	13,748	-	13,748	-
Equity securities - financial services	429	429	-	-
Total available-for-sale securities	\$ 75,821	\$ 429	\$ 70,150	\$ 5,242

Equity securities in the AFS portfolio are measured at fair value using quoted market prices for identical assets and are classified within Level 1 of the valuation hierarchy. Other than the Company's investment in corporate bonds, consisting of pooled trust preferred securities, all other debt securities in the AFS portfolio are measured at fair value using prices provided by a third-party vendor, who is a provider of financial market data, analytics and related services to financial institutions. Assets classified as Level 2 use valuation techniques that are common to bond valuations. That is, in active markets whereby bonds of similar characteristics frequently trade, quotes for similar assets are obtained. For the nine months ended September 30, 2010, there were no transfers to and from Level 1 and Level 2 fair value measurements for financial assets measured on a recurring basis.

The Company's pooled trust preferred securities include both observable and unobservable inputs to determine fair value and, therefore, are classified as Level 3 inputs. For a discussion on the fair value determination of the Company's investment in pooled trust preferred securities, see "Investment securities" under the caption "Comparison of Financial Condition at September 30, 2010 and December 31, 2009" in "Management's Discussion and Analysis of Financial Condition and Results of Operations," below.

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The following table illustrates the changes in Level 3 financial instruments, consisting of the Company's investment in pooled trust preferred securities, measured at fair value on a recurring basis for the periods indicated (dollars in thousands):

	As of and for the nine months ended September 30, 2010	As of and for the nine months ended September 30, 2009
Assets:		
Balance at beginning of period	\$ 5,242	\$ 10,260
Realized / unrealized (losses) gains:		
in earnings	(2,504)	(2,758)
in comprehensive income (loss)	988	(306)
Purchases, sales, issuances and settlements, amortization and accretion, net	-	643
Balance at end of period	\$ 3,726	\$ 7,839

The following table illustrates the financial instruments measured at fair value on a non-recurring basis segregated by hierarchy fair value levels as of September 30, 2010 and December 31, 2009 (dollars in thousands):

	Total carrying value at September 30, 2010	Fair value measurements at September 30, 2010 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Impaired loans	\$ 4,141	\$ -	\$ 4,039	\$ 102
	Total carrying value at December 31, 2009	Fair value measurements at December 31, 2009 using:		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Impaired loans	\$ 4,842	\$ 15	\$ 4,447	\$ 380

Impaired loans that are collateral dependent are written down to fair value through the establishment of specific reserves. Techniques used to value the collateral that secures the impaired loan include: quoted market prices for identical assets classified as Level 1 inputs; for Level 2, observable inputs, employed by certified appraisers for similar assets are utilized if the loan is collateral dependent and then discounted based upon the type and/or age of the appraisal, the costs to sell and maintain the underlying collateral. If the loan is not considered to be collateral dependent, any impairment may be determined based upon the present value of the reported cash flows discounted at the loan's effective interest rate. In cases where valuation techniques included inputs that are unobservable, the valuations are based on commonly used and generally accepted industry liquidation advance rates or estimates and assumptions developed by management, with significant adjustments applied to the best information available under each circumstance. These asset valuations are classified as Level 3 inputs. A net reduction or transfer out of the impaired loans with Level 2 inputs occurred during the nine month period ended September 30, 2010 based upon payments received. There were no significant transfers during the quarter in the Level 1 and Level 3 impaired loans.

A summary of the carrying amounts and estimated fair values of certain financial instruments follows as of the periods indicated (dollars in thousands):

	September 30, 2010		December 31, 2009	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Financial assets:				
Cash and cash equivalents	\$ 47,571	\$ 47,571	\$ 8,328	\$ 8,328
Held-to-maturity securities	535	585	709	765
Available-for-sale securities	86,720	86,720	75,821	75,821
FHLB stock	4,781	4,781	4,781	4,781
Loans and leases	414,185	412,054	423,124	420,908
Loans held-for-sale	1,019	1,037	1,221	1,233
Accrued interest	2,233	2,233	2,251	2,251
Financial liabilities:				
Deposit liabilities	490,883	491,438	458,994	453,264
Short-term borrowings	21,804	21,804	16,533	16,533
Long-term debt	32,000	35,774	32,000	35,017
Accrued interest	616	616	665	665

The following summarizes the methodology used to determine estimated fair values in the above table:

The carrying value of short-term financial instruments, as listed below, approximates their fair value. These instruments generally have limited credit exposure, no stated or short-term maturities and carry interest rates that approximate market.

- Cash and cash equivalents
 - Non-interest bearing deposit accounts
 - Savings, NOW and money market accounts
 - Short-term borrowings
 - Accrued interest

Securities: Except for corporate bonds consisting of preferred term securities, fair values on the other investment securities are determined by prices provided by a third-party vendor, who is a provider of financial market data, analytics and related services to financial institutions. The fair values of pooled trust preferred securities is determined based on a present value technique (income valuation) as described under the caption "Investment securities" of the comparison of financial condition at September 30, 2010 and December 31, 2009, below.

FHLB stock, or restricted regulatory equity, is carried at cost, which approximates fair value.

Loans and leases: The fair value of all loans is estimated by the net present value of the future expected cash flows discounted at current market rates.

Loans held-for-sale (HFS): For loans HFS, the fair value is estimated using rates currently offered for similar loans and are obtained from the FNMA or the FHLB.

Certificates of deposit: The fair values of certificate of deposit accounts are based on discounted cash flows using rates which approximate market rates of deposits with similar maturities.

Long-term debt: The fair value is estimated using market rates currently offered for similar borrowings.

Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is management's discussion and analysis of the significant changes in the consolidated financial condition of the Company as of September 30, 2010 compared to December 31, 2009 and a comparison of the results of operations for the three- and nine-months ended September 30, 2010 and 2009. Current performance may not be indicative of future results. This discussion should be read in conjunction with the Company's 2009 Annual Report filed on Form 10-K.

Forward-looking statements

Certain of the matters discussed in this Quarterly Report on Form 10-Q may constitute forward-looking statements for purposes of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, and as such may involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. The words "expect," "anticipate," "intend," "plan," "believe," "estimate," and similar expressions are intended to identify such forward-looking statements.

The Company's actual results may differ materially from the results anticipated in these forward-looking statements due to a variety of factors, including, without limitation:

- the effects of economic deterioration on current customers, specifically the effect of the economy on loan customers' ability to repay loans;
 - the costs and effects of litigation and of unexpected or adverse outcomes in such litigation;
- governmental monetary and fiscal policies, as well as legislative and regulatory changes, in particular the effects of the Dodd-Frank Wall Street Reform and Consumer Protection Act;
- the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Financial Accounting Standards Board and other accounting standard setters;
- the risks of changes in interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, securities and interest rate protection agreements, as well as interest rate risks;
- the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in our market area and elsewhere, including institutions operating locally, regionally, nationally and internationally, together with such competitors offering banking products and services by mail, telephone, computer and the internet;
 - technological changes;
 - acquisitions and integration of acquired businesses;
- the failure of assumptions underlying the establishment of reserves for loan and lease losses and estimations of values of collateral and various financial assets and liabilities;
 - volatilities in the securities markets;
 - deteriorating economic conditions;
 - acts of war or terrorism; and
 - disruption of credit and equity markets.

Management of the Company cautions readers not to place undue reliance on forward-looking statements, which reflect analyses only as of the date of this document. We have no obligation to update any forward-looking statements to reflect events or circumstances after the date of this document.

Readers should review the risk factors described in other documents that we file or furnish, from time to time, with the Securities and Exchange Commission, including Annual Reports to Shareholders, Annual Reports filed on Form 10-K and other current reports filed or furnished on Form 8-K.

General

The Company's results of operations depend primarily on net interest income. Net interest income is the difference between interest income and interest expense. Interest income is generated from yields on interest-earning assets,

which consist principally of loans and investment securities. Interest expense is incurred from rates paid on interest-bearing liabilities, which consist of deposits and borrowings. Net interest income is determined by the Company's interest rate spread (the difference between the yields earned on its interest-earning assets and the rates paid on its interest-bearing liabilities) and the relative amounts of interest-earning assets and interest-bearing liabilities. Interest rate spread is significantly impacted by: changes in interest rates and market yield curves and their related impact on cash flows; the composition and characteristics of interest-earning assets and interest-bearing liabilities; differences in the maturity and re-pricing characteristics of assets compared to the maturity and re-pricing characteristics of the liabilities that fund them and by the competition in our marketplace.

The Company's profitability is also affected by the level of its non-interest income and expenses, provision for loan losses and provision for income taxes. Non-interest income consists of service charges on the Bank's loan and deposit products, trust and asset management service fees, increases in the cash surrender value of the bank owned life insurance (BOLI), net gains or losses from sales of loans, securities and foreclosed assets held-for-sale and from credit-related other-than-temporary impairment (OTTI) charges on investment securities. Non-interest expense consists of compensation and related employee benefit expenses, occupancy, equipment, data processing, advertising, marketing, professional fees, insurance and other operating overhead.

The Company's profitability is significantly affected by general economic and competitive conditions, changes in market interest rates, government policies and actions of regulatory authorities. The Company's loan portfolio is comprised principally of commercial and commercial real estate loans. The properties underlying the Company's mortgages are concentrated in Northeastern Pennsylvania. Credit risk, which represents the possibility of the Company not recovering amounts due from its borrowers, is significantly related to local economic conditions in the areas the properties are located as well as the Company's underwriting standards. Economic conditions affect the market value of the underlying collateral as well as the levels of adequate cash flow and revenue generation from income-producing commercial properties.

Comparison of the results of operations
Three and nine months ended September 30, 2010 and 2009

Overview

Net income for the third quarter of 2010 was \$355,000, or \$0.16 per diluted share, compared to a net loss of \$3,211,000, or \$1.55, recorded in the same quarter of 2009. For the nine months ended September 30, 2010, net income was \$1,630,000, or \$0.76 per diluted share, compared to a net loss \$1,473,000, or \$0.71, recorded for the nine months ended September 30, 2009. The improvement in net earnings in the quarter and year-to-date comparisons was due to: a decline in non-cash, other-than-temporary impairment (OTTI) charges related to the Company's investment portfolio, lower provisions for loan losses, higher levels of net interest income, more collected fees and service charges and lower operating expenses. In addition, gains from mortgage banking services improved by \$72,000 in the quarter-to-quarter comparison and declined \$518,000 in the year-to-date comparative periods.

Return on average assets (ROA) and return on average shareholders' equity (ROE) were 0.24% and 2.87%, respectively, for the three months ended September 30, 2010 compared to -2.25% and -25.75%, respectively, for the three months ended September 30, 2009. For the nine months ended September 30, 2010, ROA and ROE were 0.37% and 4.58%, respectively, compared to -0.35% and -4.07% for the same period in 2009. The improvements in both ROA and ROE are attributable to net earnings recorded in both the current quarter and year.

Net interest income and interest sensitive assets / liabilities

Net interest income increased \$852,000, or 19%, to \$5,273,000 in the third quarter of 2010, from \$4,421,000 recorded in the same quarter of 2009. The improvement was principally from lower interest expense of \$1,352,000 due to a 126 basis point reduction in rates paid on interest-bearing liabilities, where a 76 basis point reduction in deposit rates more than offset the effect of a \$14,636,000 increase in average balances. Conversely, though average interest-earning assets increased \$16,200,000, interest income was negatively impacted by a 52 basis point decline in yields earned resulting in a net decline in interest income of \$500,000 in the third quarter of 2010 compared to the third quarter of 2009.

During the third quarter of 2010, the Company's tax-equivalent margin and spread were 3.93% and 3.68%, compared to 3.43% and 2.95%, respectively, during the third quarter of 2009. The improvement in spread was caused by a greater reduction in rates paid on interest-bearing liabilities than the lower yields earned on interest-earning assets. The improvement in margin was from higher net interest income.

For the nine months ended September 30, 2010, net interest income improved 12%, or \$1,663,000, compared to the nine months ended September 30, 2009. Similar to the third quarter comparison, the improvement was principally from lower interest expense of \$3,434,000 due to a 108 basis point reduction in rates paid on interest-bearing liabilities including an 87 basis point reduction in rates paid on deposits. The decrease in interest income of \$1,771,000 was from lower yields on earning assets.

The Company's tax-equivalent margin and spread improved to 3.92% and 3.66%, respectively, for the nine months ended September 30, 2010 from 3.62% and 3.17% during the same period of 2009. The improvements stem from deposit rates declining more rapidly than yields from earning assets resulting in higher net interest income.

The low interest rate environment has dominated the economy for several quarters and the probability of a near-term change is unlikely. As the Company continues to operate in this environment, earning assets will continue to re-price to lower levels causing additional downward pressure on yields. However, the Company's Asset Liability Management (ALM) team will, if and when deemed necessary, adjust interest rates on deposits and repurchase agreements in order to maintain acceptable interest rate margins. At this time, the Company's deposit offering rates

are at historical low levels and whether the Company can grow and retain its deposit base will largely depend on customers' desire to maintain relatively low-earning deposits. Nonetheless, the Company's ALM team will continue to proactively address interest rate issues in this difficult financial environment and is poised to create and offer products that are fair for its customers yet equitable for the Company.

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The table that follows sets forth a comparison of average balances and their corresponding fully tax-equivalent (FTE) interest income and expense and annualized tax-equivalent yield and cost for the periods indicated (dollars in thousands):

Assets	Three months ended:					
	September 30, 2010			September 30, 2009		
	Average balance	Interest	Yield / rate	Average balance	Interest	Yield / rate
Interest-earning assets:						
Loans and leases	\$ 424,053	\$ 6,295	5.89%	\$ 431,024	\$ 6,603	6.08%
Investments	94,448	845	3.55	99,922	1,065	4.23
Federal funds sold	169	-	0.26	5,335	3	0.25
Interest-bearing deposits	34,424	22	0.25	622	-	0.06
Total interest-earning assets	553,094	7,162	5.14	536,903	7,671	5.67
Non-interest-earning assets	32,848			29,089		
Total assets	\$ 585,942			\$ 565,992		
Liabilities and shareholders' equity						
Interest-bearing liabilities:						
Other interest-bearing deposits	\$ 259,678	\$ 407	0.63%	\$ 228,308	\$ 579	1.01%
Certificates of deposit	146,952	838	2.29	163,683	1,370	3.32
Borrowed funds	42,274	430	4.04	42,746	1,077	10.00
Repurchase agreements	8,685	6	0.30	7,266	6	0.32
Total interest-bearing liabilities	457,589	1,681	1.46	442,003	3,032	2.72
Non-interest-bearing deposits	75,831			70,412		
Other non-interest-bearing liabilities	3,509			4,102		
Shareholders' equity	49,013			49,475		
Total liabilities and shareholders' equity	\$ 585,942			\$ 565,992		
Net interest income / interest rate spread		\$ 5,481	3.68%	\$ 4,639		2.95%
Net interest margin			3.93%			3.43%

Assets	Nine months ended:					
	September 30, 2010			September 30, 2009		
	Average balance	Interest	Yield / rate	Average balance	Interest	Yield / rate
Interest-earning assets:						
Loans and leases	\$ 431,108	\$ 18,834	5.84%	\$ 432,607	\$ 19,866	6.14%
Investments	95,686	2,693	3.76	98,971	3,436	4.64
Federal funds sold	7,708	14	0.24	5,872	11	0.25
Interest-bearing deposits	20,181	38	0.25	722	-	0.10
Total interest-earning assets	554,683	21,579	5.20	538,172	23,313	5.79
Non-interest-earning assets	31,892			29,048		
Total assets	\$ 586,575			\$ 567,220		

Liabilities and shareholders' equity

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Interest-bearing liabilities:

Other interest-bearing deposits	\$ 260,211	\$ 1,386	1.07%	\$ 217,674	\$ 1,698	1.04%
Certificates of deposit	145,586	2,572	3.56	169,808	4,581	3.61
Borrowed funds	42,111	1,281	4.07	49,138	2,448	6.66
Repurchase agreements	12,634	77	0.81	9,144	22	0.33
Total interest-bearing liabilities	460,542	5,316	1.54	445,764	8,749	2.62
Non-interest-bearing deposits	74,917			69,143		
Other non-interest-bearing liabilities	3,502			3,950		
Shareholders' equity	47,614			48,363		
Total liabilities and shareholders' equity	\$ 586,575			\$ 567,220		
Net interest income / interest rate spread		\$ 16,263	3.66%		\$ 14,564	3.17%
Net interest margin			3.92%			3.62%

In the preceding table, interest income was adjusted to a tax-equivalent basis, using the corporate federal tax rate of 34%, to recognize the income from tax-exempt interest-earning assets as if the interest was taxable. This treatment allows a uniform comparison between yields on interest-earning assets. Loans include loans HFS and non-accrual loans but exclude the allowance for loan losses. Securities include non-accrual securities. Average balances are based on amortized cost and do not reflect net unrealized gains or losses. Net interest margin is calculated by dividing net interest income by total average interest-earning assets.

Provision for loan losses

The provision for loan losses represents the necessary amount to charge against current earnings, the purpose of which is to increase the allowance for loan losses to a level that represents management's best estimate of known and inherent losses in the Company's loan portfolio. Loans and leases determined to be uncollectible are charged off against the allowance for loan losses. The required amount of the provision for loan losses, based upon the adequate level of the allowance for loan losses, is subject to ongoing analysis of the loan portfolio. The Company's Special Assets Committee meets periodically to review problem loans and leases. The committee is comprised of management, including the senior loan officer, the chief risk officer, loan officers, loan workout officers and collection personnel. The committee reports quarterly to the Credit Administration Committee of the Board of Directors.

Management continuously reviews the risks inherent in the loan and lease portfolio. Specific factors used to evaluate the adequacy of the loan loss provision during the formal process include:

- specific loans that could have loss potential;
- levels of and trends in delinquencies and non-accrual loans;
- levels of and trends in charge-offs and recoveries;
- trends in volume and terms of loans;
- changes in risk selection and underwriting standards;
- changes in lending policies, procedures and practices;
- experience, ability and depth of lending management;
- national and local economic trends and conditions; and
- changes in credit concentrations.

The provision for loan losses was \$375,000 for the three months ending September 30, 2010 and was \$3,125,000 for the three month period ending September 30, 2009. Total provisions for the nine months ended September 30, 2010 were \$1,250,000 and \$3,850,000 for the same nine months of 2009. The \$375,000 provision for the current quarter was recorded to provide increased allocations for commercial loans, residential mortgages and consumer loans resulting from the continued locally weakened economic conditions and to reserve for a decline in real estate values. For a further discussion on non-performing loans, see "Non-performing assets" under the caption "Comparison of financial condition at September 30, 2010 and December 31, 2009", below.

The allowance for loan losses was \$7,484,000 at September 30, 2010 compared to \$7,574,000 at December 31, 2009. For a further discussion on the allowance for loan losses, see "Allowance for loan losses" under the caption "Comparison of financial condition at September 30, 2010 and December 31, 2009" below.

Other income (loss)

In the third quarter of 2010, other (non-interest) income/loss improved \$1,022,000, or 79%, from a net loss of 1,292,000 recorded in the third quarter of 2009 to a net loss of \$270,000 recorded in the third quarter of 2010. The improvement was primarily from \$683,000 lower non-cash OTTI charges recorded in the current year quarter. The OTTI is related to credit impairment in the Company's investments in pooled trust preferred securities that is discussed

more fully in Note 3, "Investment securities". Non-interest income was bolstered by a \$175,000, or 41%, increase in fees and other service charges emanating mostly from lending activities. In addition, the prolonged low interest rate environment has again spiked mortgage loan origination and refinancing activities. As such, mortgage banking services recognized \$72,000 in additional gains in the current year third quarter compared to the third quarter of 2009.

For the nine months ended September 30, 2010, other income improved \$36,000 compared to the nine months ended September 30, 2009. In the current year, the Company recognized OTTI credit-related charges of \$2,504,000 compared to \$2,758,000 in 2009, an improvement of approximately \$254,000. In addition, other fees and service charges improved \$213,000 on the strength of lending and trust services activities. Partially offsetting these positive factors for the nine months ended September 30, 2010, the Company recorded \$440,000 in gains from mortgage banking services compared to \$958,000 recognized during the first nine months of 2009, or a decline of \$518,000. The 2009 gain included sales of \$10,838,000 of loans transferred from the loan and lease portfolio to loans HFS and simultaneously sold.

Other operating expenses

For the quarter ended September 30, 2010, other (non-interest) expenses declined \$792,000, or 15%, compared to the quarter ended September 30, 2009. Salary and employee benefits decreased \$335,000, or 13%, due to employee downsizing in conjunction with the planned reorganization of the Company during the latter part of 2009 and first quarter of 2010. The number of full-time equivalent employees (FTE) amounted to 159 at September 30, 2010 compared to 185 at September 30, 2009. The \$66,000, or 8%, savings in premises and equipment is principally from lower rental expense. The Company recently entered into a new lease agreement with a new owner-landlord of the Company's Eynon branch. As a result, the company was required to reverse previously accrued and unpaid future rental obligations expensed in accordance with current accounting guidance. In conjunction with the new ownership, the previous lease agreement with the previous owner-landlord terminated. The other category of other operating expense declined \$383,000, or 24%. Professional services declined \$226,000, or 32%, due in part to the one-time \$162,000 consulting agreement expense paid to the Company's former chief executive officer in the third quarter of 2009 and to a lesser degree, the permanent exemption of smaller reporting companies from the Sarbanes-Oxley internal control audit requirement as a result of the signing into law, the Dodd-Frank Wall Street Reform and Consumer Protection Act. This enactment eliminated the need to accrue expenses for this effort. Finally, in the 2010 third quarter, credit-collection related costs were approximately half of the amount recognized in the third quarter of 2009 due to the recovery of some previously recognized expenses incurred on larger problem credits.

For the nine months ended September 30, 2010, non-interest related expenses decreased \$394,000, or 3%, from \$14,510,000 recorded in 2009 compared to \$14,116,000 in 2010. Salary and employee benefits decreased \$326,000, or 4%, despite approximately \$400,000 of one-time severance and voluntary termination payouts from the previously mentioned planned, structured reorganization of the Company. Savings in property insurance, facility maintenance and the aforementioned termination of the old and simultaneous signing of the new branch lease agreement helped reduce premises and equipment expenses by \$136,000, or 5%. Advertising expenses increased \$22,000, or 6%, due to costs for the development of a new Company website, the implementation of a Company branding campaign and the expenses associated with customer notification of federal regulatory changes. The other category of non-interest expenses increased by \$46,000, or 1% in 2010, compared to 2009, due to a sundry of offsetting components consisting of: higher collection expense caused by higher levels of non-performing loans; less deferral of mortgage-related origination costs on less origination activity; the establishment of a loss contingency reserve associated with potential off-balance sheet loan commitment losses and an increase in promotion related expenses for sales campaigns designed to bolster services for deposit customers. Partially offsetting these items were lower: professional services from the non-recurrence of the consulting payments, ORE costs, travel related expenses and sold loan charges on lower origination and sales volumes.

(Credit) provision for income taxes

For the nine months ended September 30, 2010 and 2009 the Company recorded a provision for income taxes of \$169,000 and an income tax benefit of \$1,421,000, respectively. This is a result of the Company incurring pre-tax losses during the first nine months of 2009 as compared to generating pre-tax income for the first nine months of 2010. Though the Company generated pre-tax income during the third quarter of 2010, the tax benefit was caused by a higher level net non-taxable permanent differences recognized during the same period.

Comparison of financial condition at September 30, 2010 and December 31, 2009

Overview

Consolidated assets increased \$40,581,000 to \$596,598,000 or 7%, as of September 30, 2010 from \$556,017,000 at December 31, 2009. The increase was primarily from \$31,888,000 growth in deposits, an increase in short-term borrowings of \$5,271,000 and a \$3,001,000 increase in shareholders' equity.

Investment securities

At the time of purchase, management classifies investment securities into one of three categories: trading, available-for-sale (AFS) or held-to-maturity (HTM). To date, management has not purchased any securities for trading purposes. Most of the securities purchased are classified as AFS even though there is no immediate intent to sell them. The AFS designation affords management the flexibility to sell securities and position the balance sheet in response to capital levels, liquidity needs or changes in market conditions. Securities AFS are carried at fair value in the consolidated balance sheet with an adjustment to shareholders' equity, net of tax, presented under the caption "Accumulated other comprehensive income (loss)." Securities designated as HTM are carried at amortized cost and represent debt securities that the Company has the ability and intent to hold until maturity.

As of September 30, 2010, the carrying value of investment securities amounted to \$87,255,000, or 15% of total assets, compared to \$76,530,000, or 14% of total assets, at December 31, 2009. At September 30, 2010, approximately 47% of the carrying value of the investment portfolio was comprised of mortgage-backed securities that amortize and provide monthly cash flow.

As of September 30, 2010, investment securities were comprised of HTM and AFS securities with carrying values of \$535,000 and \$86,720,000, respectively. The AFS debt securities were recorded with a net unrealized loss in the amount of \$10,780,000 and equity securities were recorded with an unrealized net gain of \$117,000. During the nine months ended September 30, 2010, the carrying value of total investments increased \$10,725,000. The increase includes \$3,268,000 in net market value appreciation in the AFS portfolio. The Company used cash flow generated from mortgage-backed securities, bond calls and pay downs as well as excess cash reserves to diversify the securities portfolio weighted heavier in mortgage-backed securities with relatively short durations and which provide a regular source of cash flow.

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A comparison of investment securities at September 30, 2010 and December 31, 2009 is as follows (dollars in thousands):

	September 30, 2010		December 31, 2009	
	Amount	%	Amount	%
Agency - GSE	\$ 17,423	20.0	\$ 33,132	43.3
MBS - GSE residential	41,252	47.3	14,457	18.9
State & municipal subdivisions	24,415	28.0	23,270	30.4
Pooled trust preferred securities	3,726	4.2	5,242	6.8
Equity securities - financial services				