COMMERCIAL NATIONAL FINANCIAL CORP /PA
Form 10-Q
May 11, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2009

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 0-18676

COMMERCIAL NATIONAL FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

PENNSYLVANIA	25-1623213
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
900 LIGONIER STREET LATROBE, PA	15650
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (724) 539-3501

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

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[X] 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 definition 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 [X]

Indicate by check mark whether the registrant is a shell company(as defined in Rule 12b-2 of the Exchange Act).

[ ]Yes [x] No

Indicate the number of shares outstanding of each of the issuer's classes of common stock.

CLASS	OUTSTANDING AT MAY 1, 2009
Common Stock, $2 Par Value	2,870,753 Shares

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PART II - OTHER INFORMATION

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COMMERCIAL NATIONAL FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(dollars in thousands, except share amounts)

	March 31, 2009 (unaudited)	December 31, 2008
ASSETS		
Cash and due from banks	$ 10,677	$ 7,111
Interest bearing deposits with banks	29	21
Total cash and cash equivalents	10,706	7,132
Investment securities available for sale	127,545	114,771
Restricted investments in bank stock	4,567	3,967
Loans receivable	210,643	215,933
Allowance for loan losses	(1,806)	(1,821)
Net loans	208,837	214,112
Premises and equipment, net	3,592	3,549
Investment in life insurance	14,676	14,555
Other assets	2,808	2,413
Total assets	$ 372,731	$ 360,499
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits (all domestic):		
Non-interest bearing	$ 67,381	$ 67,067
Interest bearing	195,935	190,020
Total deposits	263,316	257,087
Short-term borrowings	35,000	31,175
Long- term borrowings	30,000	30,000
Other liabilities	3,579	3,169
Total liabilities	331,895	321,431
Shareholders' equity:		
Common stock, par value $2 per share; 10,000,000 shares authorized; 3,600,000 issued; 2,872,753 and 2,880,953 shares outstanding in 2009 and 2008	7,200	7,200
Retained earnings	42,254	41,616
Accumulated other comprehensive income	3,747	2,490
Treasury stock, at cost, 727,247and 719,047 shares in 2009 and 2008	(12,365)	(12,238)

Total shareholders' equity		40,836		39,068
Total liabilities and shareholders' equity	$	372,731	$	360,499

The accompanying notes are an integral part of these consolidated financial statements.

COMMERCIAL NATIONAL FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands, except per share data)

	Three Months Ended March 31 2009 (unaudited)	Three Months Ended March 31 2008 (unaudited)
INTEREST INCOME:		
Interest and fees on loans	$ 3,089	$ 3,376
Interest and dividends on investments:		
Taxable	1,923	1,621
Exempt from federal income tax	13	33
Other	1	12
Total interest income	5,026	5,042
INTEREST EXPENSE		
Interest on deposits	869	1,555
Interest on short-term borrowings	58	131
Interest on long- term borrowings	285	229
Total interest expense	1,212	1,915
NET INTEREST INCOME	3,814	3,127
PROVISION FOR LOAN LOSSES	-	-
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	3,814	3,127
OTHER INCOME		
Asset management and trust income	247	257
Service charges on deposit accounts	139	150
Other service charges and fees	202	207
Income from investment in life insurance	146	140
Other income	50	45
Total other income	784	799
OTHER EXPENSES		
Salaries and employee benefits	1,434	1,445
Net occupancy expense	208	199
Furniture and equipment expense	123	134
Pennsylvania shares tax	130	133
Legal and professional	123	113
Other expense	770	784
Total other expenses	2,788	2,808
INCOME BEFORE INCOME TAXES	1,810	1,118
Income tax expense	541	302

NET INCOME	$	1,269	$	816
Average shares outstanding		2,876,191		3,028,813
EARNINGS PER SHARE, BASIC	$	0.44	$	0.27
Dividend declared per share	$	0.22	$	0.20

The accompanying notes are an integral part of these consolidated financial statements.

COMMERCIAL NATIONAL FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(dollars in thousands, except per share data)

	Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income	Total Shareholders' Equity
(unaudited)					
Balance at December 31, 2008	$ 7,200	$ 41,616	$ (12,238)	$ 2,490	$ 39,068
Comprehensive Income					
Net income	-	1,269	-	-	1,269
Other comprehensive gain, net of tax:					
Unrealized net gains on securities	-	-	-	1,257	1,257
Total Comprehensive Income					2,526
Cash dividends declared					
$0.22 per share	-	(631)	-	-	(631)
Treasury shares purchased	-	-	(127)	-	(127)
Balance at March 31, 2009	$ 7,200	$ 42,254	$ (12,365)	$ 3,747	$ 40,836
(unaudited)					
Balance at December 31, 2007	$ 7,200	$ 40,505	$ (10,681)	$ 1,437	$ 38,461
Comprehensive Income					
Net income	-	816	-	-	816
Other comprehensive gain, net of tax:					
Unrealized net gains on securities	-	-	-	831	831
Total Comprehensive Income					1,647
Cumulative effect accounting adjustment on benefit plan reserve (See note 1)	-	(431)	-	-	(431)
Cash dividends declared					
$0.20 per share	-	(606)	-	-	(606)
Balance at March 31, 2008	$ 7,200	$ 40,284	$ (10,681)	$ 2,268	$ 39,071

The accompanying notes are an integral part of these consolidated financial statements.

COMMERCIAL NATIONAL FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(unaudited)

	For Three Months Ended March 31	
	2009	2008
OPERATING ACTIVITIES		
Net income	$ 1,269	$ 816
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	100	103
Amortization of intangibles	24	24
Net accretion of loans and securities	(110)	(79)
Income from investment in life insurance	(146)	(140)
Increase in other assets	(421)	(88)
Decrease in other liabilities	(214)	(209)
Net cash provided by operating activities	502	427
INVESTING ACTIVITIES		
Increase in federal funds sold	-	(3,950)
Purchase of securities	(19,960)	-
Maturities and calls of securities	9,204	5,076
Purchase of restricted investments in bank stock	(600)	(650)
Redemption of restricted investments in bank stock	-	25
Net decrease in loans	5,272	6,155
Proceeds from sale of foreclosed real estate	2	-
Purchase of premises and equipment	(142)	(97)
Net cash provided by (used in) investing activities	(6,224)	6,559
FINANCING ACTIVITIES		
Net increase (decrease) in deposits	6,229	(14,430)
Increase in other short-term borrowings	3,825	6,825
Dividends paid	(631)	(606)
Purchase of treasury stock	(127)	-
Net cash provided by (used in) financing activities	9,296	(8,211)
Increase (decrease) in cash and cash equivalents	3,574	(1,225)
Cash and cash equivalents at beginning of year	7,132	9,929
Cash and cash equivalents at end of quarter	$ 10,706	$ 8,704
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 1,272	$ 2,003

Income Taxes	$ 510	$ 280

The accompanying notes are an integral part of these consolidated financial statements.

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COMMERCIAL NATIONAL FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2009
Note 1 Basis of Presentation

The accompanying consolidated financial statements include the accounts of Commercial National Financial Corporation (the Corporation) and its wholly owned subsidiary, Commercial Bank & Trust of PA and Ridge Properties, Inc. All material intercompany transactions have been eliminated.

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. However, they do not include all information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the annual financial statements of the Corporation for the year ended December 31, 2008, including the notes thereto. In the opinion of management, the unaudited interim consolidated financial statements include all adjustments (consisting of only normal recurring adjustments) necessary for a fair statement of financial position as of March 31, 2009 and the results of operations for the three-month period ended March 31, 2009 and 2008. The results of operations for the three months ended March 31, 2009 are not necessarily indicative of the results to be expected for the entire year.

On January 1, 2008, the Corporation changed its accounting policy and recognized a cumulative-effect adjustment to retained earnings totaling $431,245 related to accounting for certain endorsement split-dollar life insurance arrangements in connection with the adoption of Emerging Issues Task Force (“EITF”) Issue No. 06-4, “Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split Dollar Life Insurance Arrangements.” See Note 7 – New Accounting Standards Adopted.

Reclassifications
Certain comparative amounts for the prior year have been reclassified to conform to current year classifications. Such classifications had no effect on net income or equity.

Note 2 Allowance for Loan Losses

The provision for loan losses is the amount added to the allowance against which actual loan losses are charged. The amount of the provision is determined by management through an evaluation of the size and quality of the loan portfolio, economic conditions, concentrations of credit, recent loan loss trends, delinquencies and other risks inherent within the loan portfolio.

The corporation did not record a provision for the three-month periods ended March 31, 2009 and 2008.

Description of changes:

(dollars in thousands)

	2009	2008
Allowance balance January 1	$ 1,821	$ 1,869
Provision charged to operating expenses	0	0
Recoveries on previously charged off loans	0	9
Loans charged off	(15)	(46)
Allowance balance March 31	$ 1,806	$ 1,832

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Note 3 Comprehensive Income

The components of other comprehensive income (loss) and related tax effects for the three month periods ended March 31, 2009 and 2008 are as follows: (dollars in thousands)

	For three months ended March 31	
	2009	2008
Net unrealized gains on securities available for sale	$ 1,904	$ 1,258
Tax effect	(647)	(427)
Net of tax amount	$ 1,257	$ 831

Note 4 Legal Proceedings

Other than proceedings which occur in the normal course of business, there are no legal proceedings to which either the Corporation or any of its subsidiaries is a party, which, in the opinion of management, will have any material effect on the financial position or results of operations of the Corporation and its subsidiaries.

Note 5 Guarantees

The Corporation does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit written are conditional commitments issued by the Bank to secure the performance of a customer to a third party. Of these letters of credit, $448,000 automatically renews within the next twelve months and $2,357,000 will expire within thirteen to one hundred and twenty-five months. The Bank, generally, holds collateral and/or personal guarantees supporting these commitments. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The current amount of the liability as of March 31, 2009 for guarantees under standby letters of credit issued is not material.

Note 6 Earnings per share

The Corporation has a simple capital structure. Basic earnings per share equals net income divided by the weighted average common shares outstanding during each period presented. The weighted average common shares outstanding for the three months ended March 31, 2009 and 2008 was 2,876,191 and 3,028,813 respectively.

Note 7 New Accounting Standards Adopted

In January 2009, the FASB issued FSP EITF 99-20-1, “Amendments to the Impairment of Guidance of EITF Issue No. 99-20” (FSP EITF 99-20-1). FSP EITF 99-20-1 amends the impairment guidance in EITF Issue No. 99-20, “Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets”, to achieve more consistent determination of whether an other-than-temporary impairment has occurred. FSP EITF 99-20-1 also retains and emphasizes the objective of an other-than-temporary impairment assessment and the related disclosure requirements in SFAS No. 115, “Accounting for Certain Investments in Debt and Equity Securities", and other related guidance. FSP EITF 99-20-1 is effective for interim and annual reporting periods ending after December 15, 2008, and shall be applied prospectively. Retrospective application to a prior interim or annual reporting period is not permitted. The Corporation has determined this pronouncement had no impact on the consolidated financial statements.

EITF 06-4

In September 2006, the FASB's Emerging Issues Task Force (EITF) issued EITF Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split Dollar Life Insurance Arrangements" ("EITF 06-4"). EITF 06-4 requires the recognition of a liability related to the postretirement benefits covered by an endorsement split-dollar life insurance arrangement. The consensus highlights that the employer (who is also the policyholder) has a liability for the benefit it is providing to its employee. As such, if the policyholder has agreed to maintain the insurance policy in force for the employee's benefit during his or her retirement, then the liability recognized during the employee's active service period should be based on the future cost of insurance to be incurred during the employee's retirement. Alternatively, if the policyholder has agreed to provide the employee with a death benefit, then the liability for the future death benefit should be recognized by following the guidance in SFAS No. 106 or Accounting Principles Board (APB) Opinion No. 12, as appropriate. For transition, an entity can choose to apply the guidance using either of the following approaches: (a) a change in accounting principle through retrospective application to all periods presented or (b) a change in accounting principle through a cumulative-effect adjustment to the balance in retained earnings at the beginning of the year of adoption. The Company recorded a cumulative effect adjustment to retained earnings of $431,245 on January 1, 2008.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and financial Liabilities-Including an amendment of FASB Statement No. 115." SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. The Corporation adopted the provisions of FAS 159 but did not elect fair value option for any financial assets or financial liabilities as of January 1, 2008.

The Corporation adopted FASB Statement No.157 “Fair Value Measurements” (SFAS 157) effective January 1, 2008 for financial assets and liabilities that are measured and reported at fair value. There was no impact from the adoption of SFAS 157 on the amounts reported in the consolidated financial statements. SFAS 157 primary impact on the Corporation’s financial statements was to expand required disclosures pertaining to the methods used to determine fair values.

SFAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under SFAS 157 are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical,unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, forsubstantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement andunobservable (ie., supported with little or no market activity).

For assets measured at fair value on a recurring basis, the fair value measurement by level within the fair value hierarchy used at March 31, 2009 are as follows (in thousands).

	(Level 1) Quoted Prices In active Markets For Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
Securities available for sale	$ 127,545	-	-

For assets measured at fair value on a recurring basis, the fair value measurement by level within the fair value hierarchy used at December 31, 2008 are as follows (in thousands).

(Level 1) (Level 2) (Level 3)
Quoted Prices Significant Other Significant
In active
Markets Observable Unobservable
For Identical Assets Inputs Inputs

Securities available for sale -
$ 114,771 -

The following valuation techniques were used to measure fair value for available for sale securities as of March 31, 2009 and December 31, 2008

Securities Available for Sale: The Corporation utilizes a third party in determining the fair values for securities held as available for sale. For the Corporation’s agency mortgage backed securities, the third party utilizes market data, pricing models that vary based on asset class and include available trade, bid and other market information. Methodology includes

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broker quotes, proprietary modes, vast descriptive terms and conditions. The third party uses their own proprietary valuation Matrices in determining fair values for municipal bonds. These Matrices utilize comprehensive municipal bond interest rate tables daily to determine market price, movement and yield relationships.

We may be required to measure certain other financial assets at fair value on a nonrecurring basis. These adjustments to fair value usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets. The Level 3 disclosures shown below represent the carrying value of loans for which adjustments are primarily based on the appraised value of collateral or the present value of expected future cash flows, which often results in significant management assumptions and input with respect to the determination of fair value. There were no realized or unrealized gains or losses relating to Level 3 financial assets and liabilities measured on a nonrecurring basis for the quarter ended March 31, 2009 and December 31, 2008.

For assets measured at fair value on a nonrecurring basis, the fair value measurement by level within the fair value hierarchy used at March 31, 2009 are as follows (in thousands).

	(Level 1) Quoted Prices In active Markets For Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
Impaired Loans	-	-	$652

Impaired loans at March 31, 2009, which are measured using the fair value of the collateral less estimated costs to sell for collateral-dependent loans, had a carrying amount of $724,000 with a valuation allowance of $72,000.

For assets measured at fair value on a nonrecurring basis, the fair value measurement by level within the fair value hierarchy used at December 31, 2008 are as follows (in thousands).

	(Level 1) Quoted Prices In active Markets For Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
Impaired Loans	-	-	$3,570

The decrease in impaired loans is due to an upgrade of one $2.8 million relationship, which had lost a sizable anchor tenant, resulting in a need for restructured terms of repayment. Since year-end 2008, the borrower has been able to negotiate a favorable lease with a replacement tenant.

The Corporation’s adoption of SFAS 157 applies only to its financial instruments required to be reported at fair value. The adoption did not apply to those non-financial assets and non-financial liabilities for which the adoption was delayed until January1, 2009 in accordance with FSP- FAS 157-2. The option of FAS 157-2 had no impact on the results of operations or financial condition as of March 31, 2009.

In October 2008, the FASB issued FSP SFAS No. 157-3, “Determining the Fair Value of a Financial Asset When The Market for That Asset Is Not Active” (FSP 157-3), to clarify the application of the provisions of SFAS 157 in an inactive market and how an entity would determine fair value in an inactive market. FSP 157-3 is effective immediately and applies to our first quarter 2009 financial reporting. The application of the provisions of FSP 157-3 did not materially affect our results of operations or financial condition as of and for the period ended March 31, 2009.

In April 2008, the FASB issued FASB Staff Position (“FSP”) FAS 142-3, “Determination of the Useful Life of Intangible Assets.” This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, “Goodwill and Other Intangible Assets” (“SFAS 142”). The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141R, and other GAAP. This FSP is effective for financial statements issued for fiscal years beginning after
December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. The Corporation has determined this FSP has had no material effect on our result of operations or financial condition as of and for the period ended March 31,2009.

In November 2008, the FASB ratified Emerging Issues Task Force (EITF) Issue No. 08-6, "Equity Method Investment Accounting Considerations". EITF 08-6 clarifies the accounting for certain transactions and impairment considerations involving equity method investments. EITF 08-6 is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. The Corporation has determined this EITF has no impact on our result of operations or financial condition as of and for the period ended March 31,2009.

Note 8 New Accounting Standards

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." This Statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements. This Statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." The Corporation is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements.

In November 2008, the SEC released a proposed roadmap regarding the potential use by U.S. issuers of financial statements prepared in accordance with International Financial Reporting Standards (IFRS). IFRS is a comprehensive series of accounting standards published by the International Accounting Standards Board ("IASB"). Under the proposed roadmap, the Corporation may be required to prepare financial statements in accordance with IFRS as early as 2014. The SEC will make a determination in 2011 regarding the mandatory adoption of IFRS. The Corporation is currently assessing the impact that this potential change would have on its consolidated financial statements, and it will continue to monitor the development of the potential implementation of IFRS.

In April 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP FAS 157-4). FASB Statement 157, Fair Value Measurements, defines fair value as the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. FSP FAS 157-4 provides additional guidance on determining when the volume and level of activity for the asset or liability has significantly decreased. The FSP also includes guidance on identifying circumstances when a transaction may not be considered orderly.

FSP FAS 157-4 provides a list of factors that a reporting entity should evaluate to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed and significant adjustments to the related prices may be necessary to estimate fair value in accordance with Statement 157.

This FSP clarifies that when there has been a significant decrease in the volume and level of activity for the asset or liability, some transactions may not be orderly. In those situations, the entity must evaluate the weight of the evidence to determine whether the transaction is orderly. The FSP provides a list of circumstances that may indicate that a transaction is not orderly. A transaction price that is not associated with an orderly transaction is given little, if any, weight when estimating fair value.

This FSP is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. An entity early adopting FSP FAS 157-4 must also early adopt FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments. The Company is currently reviewing the effect this new pronouncement will have on its consolidated financial statements.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP FAS 115-2 and FAS 124-2). FSP FAS 115-2 and FAS 124-2 clarifies the interaction of the factors that should be considered when determining whether a debt security is other-than-temporarily impaired. For debt securities, management must assess whether (a) it has the intent to sell the security and (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery. These steps are done before assessing whether the entity will recover the cost basis of the investment. Previously, this assessment required management to assert it has both the intent and the ability to hold a security for a period of time sufficient to allow for an anticipated recovery in fair value to avoid recognizing an other-than-temporary impairment. This change does not affect the need to forecast recovery of the value of the security through either cash flows or market price.

In instances when a determination is made that an other-than-temporary impairment exists but the investor does not intend to sell the debt security and it is not more likely than not that it will be required to sell the debt security prior to its anticipated recovery, FSP FAS 115-2 and FAS 124-2 changes the presentation and amount of the other-than-temporary impairment recognized in the income statement. The other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income.

This FSP is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. An entity early adopting FSP FAS 115-2 and FAS 124-2 must also early adopt FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly. The Company is currently reviewing the effect this new pronouncement will have on its consolidated financial statements.

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP FAS 107-1 and APB 28-1). FSP FAS 107-1 and APB 28-1 amends FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in summarized financial information at interim reporting periods.

This FSP is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. An entity early adopting FSP FAS 107-1 and APB 28-1 must also early adopt FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly and FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments. The Company is currently reviewing the effect this new pronouncement will have on its consolidated financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

SAFE HARBOR STATEMENT

Forward-looking statements (statements which are not historical facts) in this Quarterly Report on Form 10-Q are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the generality of the foregoing, words such as "may," "will," "to," "expect," "believe," "anticip "intend," "could," "would," "estimate," or "continue" or the negative or other variations thereof or comparable terminology intended to identify forward-looking statements. These statements are based on information currently available to the Corporation, and the Corporation assumes no obligation to update these statements as circumstances change. Investors are cautioned that all forward-looking statements involve risk and uncertainties, including changes in general economic and financial market conditions, unforeseen credit problems, and the Corporation's ability to execute its business plans. The actual results of future events could differ materially from those stated in any forward-looking statements herein.

CRITICAL ACCOUNTING ESTIMATES

Disclosure of the Corporation's significant accounting policies is included in Note 1 to the Corporation's Consolidated Financial Statements contained in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2008 (the 2008 Annual Report). Some of these policies are particularly sensitive, requiring that significant judgments, estimates and assumptions be made by management. Additional information is contained in the Management's Discussion and Analysis section of the 2008 Annual Report for the most sensitive of these issues, including the provision and allowance for loan losses.

Significant estimates are made by management in determining the allowance for loan losses. Management considers a variety of factors in establishing these estimates, including current economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, financial and managerial strengths of borrowers, adequacy of collateral (if collateral dependent) and other relevant factors. Estimates related to the value of collateral also have a significant impact on whether or not the Corporation continues to accrue income on delinquent loans and on the amounts at which foreclosed real estate is recorded in the Consolidated Statements of Financial Condition. Management discussed the development and selection of critical accounting estimates and related Management and Discussion and Analysis disclosure with the Corporation's Audit Committee. There were no material changes made to the critical accounting estimates during the periods presented within.

OVERVIEW

The Corporation had net income of $1.3 million or $0.44 per share, for the first quarter ended March 31, 2009 compared to $816,000 or $0.27 per share for the quarter ended March 31, 2008. The Corporation's return on average assets for the first quarter of 2009 and 2008 was 1.37% and 0.90%, respectively. Return on average equity for the same two periods was 12.76% and 8.44%, respectively.

The Corporation's largest segment of operating results is dependent upon net interest income. Net interest income is interest earned on interest-earning assets less interest paid on interest-bearing deposits. For the first quarter ended March 31, 2009 and 2008, net interest income was $3.8 million and $3.1 million, respectively.

The Board of Directors of the Federal Deposit Insurance Corporation (FDIC) voted to amend the restoration plan for the Deposit Insurance Fund (DIF). The FDIC Board also took action to ensure the continued strength of the insurance fund by imposing a special assessment on insured institutions of 20 basis points, implementing changes to the risk-based assessment system, and setting rates beginning the second quarter of 2009. The amended restoration plan was accompanied by a final rule that sets assessment rates and makes adjustments that improve how the assessment system differentiates for risk. Currently most banks are in a risk category with assessments between 12 cents per $100 of deposits to 14 cents per $100 of deposits in insurance. Under the final rule, most banks will pay initial base rates of between 12 and 16 cents per $100 in deposits on an annual basis beginning April 1, 2009. The FDIC board also adopted an interim rule imposing a special emergency assessment of 20 cents per $100, payable September 30, 2009. In addition, the interim FDIC ruling also permits the Board to impose an emergency special assessment after June 30, 2009 of up to 10 basis points if necessary to maintain public confidence in federal deposit insurance. The FDIC may reduce the emergency assessment payable on September 30, 2009 from 20 cents to 10 cents per $100 if congress expands the FDIC's borrowing authority with the Treasury Department to $100 billion. The Corporation anticipates special assessment will effect the quarter ending June 30, 2009.

FINANCIAL CONDITION

The Corporation's total assets increased by $12.2 million, or 3.4% from December 31, 2008 to March 31, 2009. Investments Available for Sale increased by $12.8 million. The increase in investments was due to the purchase of $20.0 million in GNMA mortgage backed securities, principal pay-downs on mortgage backed securities of $9.2 million and $1.9 million increase in the fair value of the securities. Net loans outstanding decreased by $5.3 million. The decrease in loans was a result of declines in the following categories; $500,000 in commercial loans, $1.7 million in commercial mortgages, $1.2 million in installment loans and $1.8 million in mortgages. The Corporation attributes the loan declines to consumer and commercial customers being cautious in the first quarter of 2009.

The Corporation's total deposits increased $6.2 million from December 31, 2008 to March 31, 2009. Non-interest bearing deposits increased by $300,000 and interest-bearing deposits increased by $5.9 million. The increase in interest-bearing deposits was mainly due to a $4.6 million increases in money market accounts, a $2.0 million increase in savings accounts, a $200,000 increase in now accounts and a $300,000 increase in individual retirement accounts. These increases were offset by $1.4 million decline in certificate of deposits. The Corporation attributes the increase in money market accounts to customers placing their funds in liquid, FDIC insured accounts that provide flexibility and safety.

Shareholders' equity was $40.8 million on March 31, 2009 compared to $39.1 million on December 31, 2008. Total shareholders equity increased due to the $1.3 million in net income and a $1.3 million net of tax increase in other comprehensive income due to increases in fair value of securities available for sale. These increases were offset by $631,000 paid in dividends to shareholders and $127,000 in Treasury stock purchases. Book value per common share increased from $13.56 at December 31, 2008 to $14.21 at March 31, 2009.

RESULTS OF OPERATIONS

First Three Months of 2009 as compared to the First Three Months of 2008

Net income for the first three months of 2009 was $1.3 million compared to $816,000 for the same period of 2008, representing a 55.51% increase.

Interest income for the three months ended March 31, 2009 was $5.0 million, the same as March 31, 2008. Loan income decreased in 2009 due to lower average loan balances in 2009 and lower yields. The yield on the loan portfolio for the first three months of 2009 decreased twenty-two (22) basis points to 5.80% from 6.02% in 2008. In addition, average loan balances decreased 5.00% in 2009 compared with the averages for the first quarter 2008. Security income for the three months ended March 31, 2009 was $1.9 million, an increase of 16.27% or $200,000 in comparison to $1.7 million security income in 2008. The yield on the securities portfolio for the first three months of 2009 increased one (1) basis point to 6.04%. In addition, average securities balances increased 16.02% in 2009 compared to 2008. The yield on total average earning assets for the first three months of 2009 decreased thirteen (13) basis points to 5.89% compared to 2008.

Total interest expense of $1.2 million for the first three months of 2009 decreased by $703,000 or 36.71% from the first three months of 2008. In the first quarter of 2009, the average interest bearing liabilities balances increased 1.47% and the cost of these liabilities decreased to 1.85% in 2009 from 2.96% in 2008. The cost of interest-bearings liabilities declined in 2009 due to lower market rates for certificates of deposits and short-term borrowings in comparison to 2008.

As a result of the foregoing, net interest income for the first three months of 2009 was $3.8 million compared to $3.1 million for the first three months of 2008.

The Corporation did not record a provision for loan losses for the three months ended March 31, 2009, or March 31, 2008. The Corporation's high credit quality and the decrease in loan balances led to the determination that no provision was necessary for the first three months of 2009.

Non- interest income for the first three months of 2009 was $784,000, a decrease from $799,000 for first three months of 2008. Asset management and trust income declined by $10,000, service charges on deposit accounts decreased by $11,000 and other service charges decreased by $5,000. These decreases were partially offset by a $6,000 increase in income from investments in life insurance and a $5,000 increase in other income.

Non-interest expense for the first three months of 2009 was $2.8 million, the same as 2008. Personnel costs decreased $11,000, net occupancy increased $9,000, furniture and equipment expense decreased $11,000. PA shares tax decreased slightly by $3,000 and legal and audit increased by $10,000. Other expenses decreased by $14,000.

Federal income tax for the first three months of 2009 was $541,000 compared to $302,000 for the same period in 2008. The effective tax rates for the first three months of 2009 and 2008 were 29.9% and 27.0%, respectively.

LIQUIDITY

Liquidity measurements evaluate the Corporation's ability to meet the cash flow requirements of its depositors and borrowers. The most desirable source of liquidity is deposit growth. Additional liquidity is provided by the maturity of investments in loans and securities and the principal and interest received from those earning assets. Another source of liquidity is represented by the Corporation's ability to sell both loans and securities. The Bank is a member of the Federal Home Loan Bank (FHLB) system. The FHLB provides an additional source for liquidity for long- and short-term funding. Additional sources of funding from financial institutions have been established for short-term funding needs.

The statement of cash flows for the first three months of 2009, indicates cash was provided by the decrease in loan balances, the maturities and calls of securities, the increase in deposits and the increase in short term borrowings. These sources of cash were used to purchase securities within the quarter.

As of March 31, 2009, the Corporation had available funding of approximately $139 million at the FHLB, with an additional $19 million of short term funding available through other lines of credit. The Corporation's maximum borrowing capacity with the Federal Home Loan Bank (FHLB) as of March 31, 2009 was $204 million, with $65 million borrowed resulting in the $139 million as available.

OFF BALANCE SHEET ARRANGEMENTS

The Corporation's financial statements do not reflect off balance sheet arrangements that consist of commitments to purchase securities or commitments to extend credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have

fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation evaluates
each customer's credit worthiness on a case-by-case basis. The amount of collateral, if any, which the Corporation obtains from the customer upon extension of credit, is based on management's credit evaluation of the customer or other obligor. The types of collateral obtained by the Corporation may include accounts receivable, inventory, property, plant and equipment and income-producing commercial properties.

Standby letters of credit, financial standby letters of credit and commercial letters of credit written are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

The following table identifies the Corporation's commitments to extend credit and obligations under letters of credit as of March 31, 2009 (dollars in thousands):

	TOTAL AMOUNT COMMITTED
Financial instruments whose contractual amounts represent credit risk:	
Commitments to extend credit	$33,156
Standby letters of credit	448
Financial standby letters of credit	2,357

CREDIT QUALITY RISK

The following table presents a comparison of loan quality as of March 31, 2009 with that as of December 31, 2008. Cash payments received on non-accrual loans are recognized as interest income as long as the remaining balance of the loan is deemed to be fully collectible. When doubt exists as to the collectibility of a loan in non-accrual status, any payments received are applied to principal to the extent the doubt is eliminated. Once a loan is placed on non-accrual status, any unpaid interest is charged against income.

	At or For the Three months ended March 31, 2009	At or For the Year ended December 31, 2008
	(dollars in thousands)	
Non-performing loans:		
Loans on non-accrual basis	$ 138	$ 29
Past due loans > 90 days	-	-
Renegotiated loans	3,560	3,566
Total non-performing loans	3,698	3,595
Foreclosed real estate	612	614