EMCLAIRE FINANCIAL CORP
Form 10-K
March 22, 2010

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One):

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

For the fiscal year ended: December 31, 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: 000-18464

EMCLAIRE FINANCIAL CORP.
(Exact name of registrant as specified in its charter)

Pennsylvania (State or other jurisdiction of incorporation or organization)	25-1606091 (I.R.S. Employer Identification No.)
612 Main Street, Emlenton, PA (Address of principal executive office)	16373 (Zip Code)

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

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

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

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

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

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company.
Large accelerated filer ¨ 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 Act). YES ¨ NO x.

As of June 30, 2009, the aggregate value of the 1,258,798 shares of Common Stock of the Registrant issued and outstanding on such date, which excludes 172,606 shares held by the directors and officers of the Registrant as a group, was approximately $22.7 million. This figure is based on the last sales price of $18.00 per share of the Registrant's Common Stock on June 30, 2009.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2010 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K.

EMCLAIRE FINANCIAL CORP.

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

PART I

Item 1. Business

General

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

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

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

On August 28, 2009, the Bank completed the purchase of a former National City Bank full service branch office in Titusville, Pennsylvania. Through the acquisition of this office, the Bank assumed $90.8 million in deposits in exchange for $32.6 million in loans, $54.9 million in net cash and certain fixed assets of the office.

On December 23, 2008 the Corporation issued to the U.S. Department of the Treasury (U.S. Treasury), in exchange for aggregate consideration of $7.5 million, 7,500 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A, with a liquidation preference of $1,000, and a ten year warrant to purchase up to 50,111 shares of the Corporation's common stock at an exercise price of $22.45 per share. The preferred securities pay cumulative dividends of 5% a year for the first five years and 9% a year thereafter.

On October 17, 2008, the Corporation completed the acquisition of Elk County Savings and Loan Association (ECSLA) and the merger conversion of ECSLA with and into the Bank. Associated with the merger conversion, the Corporation also conducted a common stock offering to eligible depositors and borrowers of ECSLA and the general public. The merger conversion and the offering generated $4.5 million in additional equity for the Corporation.

At December 31, 2009, the Corporation had $467.5 million in total assets, $37.0 million in stockholders' equity, $292.6 million in loans and $385.3 million in deposits.

Lending Activities

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

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

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

Commercial Business and Commercial Real Estate Loans. Commercial lending constitutes a significant portion of the Bank's lending activities. Commercial business and commercial real estate loans amounted to 44.5% of the total loan portfolio at December 31, 2009. Commercial real estate loans generally consist of loans granted for commercial purposes secured by commercial or other nonresidential real estate. Commercial loans consist of secured and unsecured loans for such items as capital assets, inventory, operations and other commercial purposes.

Consumer Loans. Consumer loans generally consist of fixed-rate term loans for automobile purchases, home improvements not secured by real estate, capital and other personal expenditures. The Bank also offers unsecured revolving personal lines of credit and overdraft protection.

Loans to One Borrower. National banks are subject to limits on the amount of credit that they can extend to one borrower. Under current law, loans to one borrower are limited to an amount equal to 15% of unimpaired capital and surplus on an unsecured basis, and an additional amount equal to 10% of unimpaired capital and surplus if the loan is secured by readily marketable collateral. At December 31, 2009, the Bank's loans to one borrower limit based upon 15% of unimpaired capital was $5.6 million. At December 31, 2009, the Bank's largest single lending relationship had an outstanding balance of $7.0 million. Credit granted to this borrower in excess of the legal lending limit is part of the Legal Lending Limit Pilot Program approved by the OCC which allows the Bank to exceed its legal lending limit within certain parameters. The Bank's next largest single lending relationship had an outstanding balance of $4.3 million at December 31, 2009. Both loans were performing in accordance with their loan terms at December 31, 2009.

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

Dollar amounts in thousands)	2009		2008		2007		2006		2005	
	Dollar Amount	%	Dollar Amount	%	Dollar Amount	%	Dollar Amount	%	Dollar Amount	%
gage loans on real estate:										
dential first mortgages	$ 74,099	25.0%	$ 74,130	27.7%	$ 65,706	28.3%	$ 64,662	30.0%	$ 66,011	3
e equity loans and lines of credit	77,284	26.1%	57,454	21.5%	49,426	21.3%	47,330	22.0%	39,933	2
mercial	89,952	30.4%	85,689	32.1%	71,599	30.9%	61,128	28.4%	52,990	2
real estate loans	241,335	81.5%	217,273	81.3%	186,731	80.5%	173,120	80.4%	158,934	8
r loans:										
mercial business	41,588	14.1%	40,787	15.2%	35,566	15.3%	34,588	16.0%	27,732	1
umer	12,894	4.4%	9,429	3.5%	9,679	4.2%	7,671	3.6%	7,729	
other loans	54,482	18.5%	50,216	18.7%	45,245	19.5%	42,259	19.6%	35,461	1
loans receivable	295,817	100.0%	267,489	100.0%	231,976	100.0%	215,379	100.0%	194,395	10
vance for loan losses	3,202		2,651		2,157		2,035		1,869	
oans receivable	$ 292,615		$ 264,838		$ 229,819		$ 213,344		$ 192,526	

The following table sets forth the scheduled contractual principal repayments or interest repricing of loans in the Corporation’s portfolio as of December 31, 2009. Demand loans having no stated schedule of repayment and no stated maturity are reported as due within one year.

(Dollar amounts in thousands)	Due in one year or less	Due from one to five years	Due from five to ten years	Due after ten years	Total
Residential mortgages	$ 1,523	$ 3,976	$ 13,216	$ 55,384	$ 74,099
Home equity loans and lines of credit	913	6,680	25,475	44,216	77,284
Commercial mortgages	2,428	5,348	13,545	68,631	89,952
Commercial business	3,001	7,939	6,462	24,186	41,588
Consumer	357	6,985	384	5,168	12,894
	$ 8,222	$ 30,928	$ 59,082	$ 197,585	$ 295,817

The following table sets forth the dollar amount of the Corporation’s fixed and adjustable rate loans with maturities greater than one year as of December 31, 2009:

(Dollar amounts in thousands)	Fixed rates	Adjustable rates
Residential mortgage	$ 47,778	$ 24,798
Home equity loans and lines of credit	61,058	15,313

Commercial mortgage	39,772	47,752
Commercial business	37,218	1,369
Consumer	12,537	-
	$ 198,363	$ 89,232

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

Delinquencies and Classified Assets

Delinquent Loans and Real Estate Acquired Through Foreclosure (REO). Typically, a loan is considered past due and a late charge is assessed when the borrower has not made a payment within fifteen days from the payment due date. When a borrower fails to make a required payment on a loan, the Corporation attempts to cure the deficiency by contacting the borrower. The initial contact with the borrower is made shortly after the seventeenth day following the due date for which a payment was not received. In most cases, delinquencies are cured promptly.

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

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

As of December 31, 2009, the Corporation’s non-performing assets, which consist of non-accrual loans, loans delinquent due to maturity, troubled debt restructuring, repossessions and REO, amounted to $2.6 million or 0.56% of the Corporation’s total assets compared to $1.1 million or 0.28% of the Corporation’s total assets at December 31, 2008. This increase was due to continued pressure on borrowers related to the prevailing poor economic climate. Interest income of $218,000 would have been recorded in 2009 if these loans had been current and performing during the entire period. Interest of $139,000 on these loans was included in income during 2009.

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

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

The Corporation regularly reviews the problem loans and other assets in its portfolio to determine whether any require classification in accordance with the Corporation’s policy and applicable regulations. As of December 31, 2009, the Corporation’s classified and criticized assets amounted to $16.6 million or 3.6% of total assets, with $10.2 million classified as substandard, $180,000 classified as doubtful and $6.3 million identified as special mention.

Included in classified and criticized assets at December 31, 2009 are two separate large loans which have certain credit problems potentially impacting the ability of the borrowers to comply with their present loan repayment terms on a timely basis.

The first loan, with an outstanding balance of $3.0 million at December 31, 2009, was originated for the construction of a hotel, restaurant and retail plaza secured by such property, the borrower's personal residence, a separate residence and a separate farm. The hotel, restaurant and retail plaza are complete and operational. However, cash flows from operations have not been constant and are impacted by the seasonal nature of the hotel. In addition, the borrower does not have other liquid sources of cash flow. As a result, the borrower has listed substantial real estate holdings for sale. Pending such sales, the Bank anticipates that the relationship may continue to have cash flow issues which may impact the timely payment of principal and interest to the Bank. At December 31, 2009, the loan was current but identified as special mention. Ultimately, due to the estimated value of the borrower's significant real estate holdings, the Bank does not currently expect to incur any significant loss on this loan.

The second loan, with an outstanding balance of $2.3 million at December 31, 2009, is a consumer installment loan for the purpose of consolidating various personal debts. This loan is secured by a lien on the primary residence of the first borrower discussed above, an assigned life insurance policy and the assignment of patent royalty income. Due to business difficulties and decreased royalty income, payments on the loan have not always been timely. At December 31, 2009, the loan was performing but was classified as substandard. As a result of the estimated value of the lien on the property owned by the first borrower, the estimated cash flow of royalty income and the borrower's business prospects, the Bank does not currently expect to incur any significant loss on this loan.

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

(Dollar amounts in thousands)	2009	2008	2007	2006	2005
Non-performing loans	$ 2,418	$ 1,011	$ 952	$ 1,841	$ 1,452
Total as a percentage of gross loans	0.82%	0.38%	0.41%	0.85%	0.75%
Repossessions	40	-	-	-	-
Real estate acquired through foreclosure	173	50	129	98	106
Total as a percentage of total assets	0.05%	0.01%	0.04%	0.03%	0.04%
Total non-performing assets	$ 2,631	$ 1,061	$ 1,081	$ 1,939	$ 1,558
Total non-performing assets as a percentage of total assets	0.56%	0.28%	0.35%	0.65%	0.57%
Allowance for loan losses as a percentage of non-performing loans	132.42%	262.22%	226.58%	110.54%	128.72%

Allowance for Loan Losses. Management establishes allowances for estimated losses on loans based upon its evaluation of the pertinent factors underlying the types and quality of loans; historical loss experience based on volume and types of loans; trend in portfolio volume and composition; level and trend on non-performing assets; detailed analysis of individual loans for which full collectibility may not be assured; determination of the existence and realizable value of the collateral and guarantees securing such loans and the current economic conditions affecting the collectibility of loans in the portfolio. The Corporation analyzes its loan portfolio at least quarterly for valuation purposes and to determine the adequacy of its allowance for losses. Based upon the factors discussed above, management believes that the Corporation's allowance for losses as of December 31, 2009 of $3.2 million was adequate to cover probable losses inherent in the portfolio at such time.

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

(Dollar amounts in thousands)	2009	2008	2007	2006	2005
Balance at beginning of period	$ 2,651	$ 2,157	$ 2,035	$ 1,869	$ 1,810
Provision for loan losses	1,367	500	256	358	205
Allowance for loan losses of ECSLA	-	206	-	-	-
Charge-offs:					
Residential mortgage loans	(35)	(10)	(48)	(71)	(45)
Commercial mortgage loans	(477)	(82)	(34)	(83)	(1)
Commercial business loans	(264)	-	(22)	(18)	(60)
Consumer loans	(83)	(160)	(60)	(49)	(91)
	(859)	(252)	(164)	(221)	(197)
Recoveries:					
Residential mortgage loans	-	-	1	-	-
Commercial business loans	7	15	16	19	18
Consumer loans	36	25	13	10	33
	43	40	30	29	51
Net charge-offs	(816)	(212)	(134)	(192)	(146)
Balance at end of period	$ 3,202	$ 2,651	$ 2,157	$ 2,035	$ 1,869
Ratio of net charge-offs to average loans outstanding	0.29%	0.08%	0.06%	0.09%	0.08%
Ratio of allowance to total loans at end of period	1.08%	0.99%	0.93%	0.94%	0.96%

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

(Dollar amounts in thousands)	2009		2008		2007		2006		2005	
Loan Categories:	Dollar Amount	Percent of loans in each category to total loans	Dollar Amount	Percent of loans in each category to total loans	Dollar Amount	Percent of loans in each category to total loans	Dollar Amount	Percent of loans in each category to total loans	Dollar Amount	Percent of loans in each category to total loans

Commercial, financial and agricultural	$ 448	14.1%	$ 431	15.2%	$ 387	15.3%	$ 532	16.0%	$ 554	14.2%
Commercial mortgages	1,891	30.4%	1,369	32.1%	1,068	30.9%	820	28.4%	841	27.3%
Residential mortgages	356	25.0%	363	27.7%	309	28.3%	239	30.0%	211	34.0%
Home equity loans	452	26.1%	467	21.5%	368	21.3%	339	22.0%	150	20.5%
Consumer loans	51	4.4%	73	3.5%	79	4.2%	83	3.6%	106	4.0%
Unallocated	4	-	(52)	-	(54)	-	22	-	7	-
	$ 3,202	100%	$ 2,651	100%	$ 2,157	100%	$ 2,035	100%	$ 1,869	100%

Investment Activities

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

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

The following table sets forth certain information regarding the fair value, weighted average yields and contractual maturities of the Corporation’s securities as of December 31, 2009:

(Dollar amounts in thousands)	Due in 1 year or less	Due from 1 to 3 years	Due from 3 to 5 years	Due from 5 to 10 years	Due after 10 years	No scheduled maturity	Total
U.S. Treasury and federal agency	$ -	$ 1,004	$ 993	$ 1,004	$ -	$ -	$ 3,001
U.S. government sponsored entities and agencies	-	27,928	18,926	3,943	-	-	50,797
Mortgage-backed securities: residential	105	277	488	3,928	11,732	-	16,530
Collateralized mortgage obligations	-	-	-	-	5,130	-	5,130
State and political subdivision	-	101	1,014	11,380	14,472	-	26,967
Equity securities	-	-	-	-	-	2,818	2,818
Estimated fair value	$ 105	$ 29,310	$ 21,421	$ 20,255	$ 31,334	$ 2,818	$ 105,243
Weighted average yield (1)	4.09%	1.79%	2.97%	5.15%	5.24%	3.15%	3.74

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

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

(Dollar amounts in thousands)	2009	2008	2007
U.S. Treasury and federal agency	$ 3,001	$ -	$ -
U.S. government sponsored entities and agencies	50,797	20,077	29,334
Mortgage-backed securities: residential	16,530	17,218	1,884
Collateralized mortgage obligations	5,130	13,162	-
State and political subdivision	26,967	13,808	14,251
Corporate securities	-	3,984	2,939
Equity securities	2,818	3,194	3,511
	$ 105,243	$ 71,443	$ 51,919

For additional information regarding the Corporation’s investment portfolio see “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in item 7 and “Notes to Consolidated Financial Statements” beginning on page F-7.

Sources of Funds

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

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

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

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

The following table sets forth maturities of the Corporation's certificates of deposit of $100,000 or more at December 31, 2009 by time remaining to maturity:

(Dollar amounts in thousands)	Amount
Less than three months	$ 3,442
Over three months to six months	3,306
Over six months to twelve months	5,020
Over twelve months	37,545
	$ 49,313

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

(Dollar amounts in thousands)	2009	2008
Ending balance	$ 40,000	$ 48,188
Average balance	50,611	45,096
Maximum balance	75,000	54,683
Weighted average rate	3.34%	3.89%

For additional information regarding the Corporation's deposit base and borrowed funds, see "Management's Discussion and Analysis of Financial Condition and Results of Operations" in item 7 and "Notes to Consolidated Financial Statements" beginning on page F-7.

Subsidiary Activity

The Corporation has two wholly owned subsidiaries, the Bank, a national association and the Title Company. As of December 31, 2009, the Bank and the Title Company had no subsidiaries.

Personnel

At December 31, 2009, the Bank had 119 full time equivalent employees. There is no collective bargaining agreement between the Bank and its employees, and the Bank believes its relationship with its employees to be satisfactory.

Competition

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

Supervision and Regulation

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

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

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

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

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

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

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

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

The Corporation’s securities are registered with the SEC under the Exchange Act. As such, the Corporation is subject to the information, proxy solicitation, insider trading, corporate governance, and other requirements and restrictions of the Exchange Act. The public may obtain all forms and information filed with the SEC through their website http://www.sec.gov.

The Bank. As a national banking association, the Bank is subject to primary supervision, examination and regulation by the OCC. The Corporation is also subject to regulations of the FDIC as administrator of the Deposit Insurance Fund (DIF) and the FRB. If, as a result of an examination of the Bank, the OCC should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of the Corporation's operations are unsatisfactory or that the Bank is violating or has violated any law or regulation, various remedies are available to the OCC. Such remedies include the power to enjoin "unsafe or unsound practices," to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in capital, to restrict the Bank's growth, to assess civil monetary penalties, and to remove officers and directors. The FDIC has similar enforcement authority, in addition to its authority to terminate the Bank's deposit insurance in the absence of action by the OCC and upon a finding that the Bank is operating in an unsafe or unsound condition, is engaging in unsafe or unsound activities, or that the Corporation's conduct poses a risk to the deposit insurance fund or may prejudice the interest of its depositors.

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

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

- The prohibition of accounting firms from providing various types of consulting services to public clients and requiring accounting firms to rotate partners among public client assignments every five years;
- Increased penalties for financial crimes and forfeiture of executive bonuses in certain circumstances;
- Required executive certification of financial presentations;
- Increased requirements for board audit committees and their members;
- Enhanced disclosure of controls and procedures and internal control over financial reporting;
- Enhanced controls on, and reporting of, insider trading; and
- Statutory separations between investment bankers and analysts.

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

USA PATRIOT Act of 2001. The USA PATRIOT Act of 2001 and its implementing regulations significantly expanded the anti-money laundering and financial transparency laws. Under the USA PATRIOT Act, financial institutions are subject to prohibitions regarding specified financial transactions and account relationships, as well as enhanced due diligence and "know your customer" standards in their dealings with foreign financial institutions and foreign customers. For example, the enhanced due diligence policies, procedures and controls generally require financial institutions to take reasonable steps:

- To conduct enhanced scrutiny of account relationships to guard against money laundering and report any suspicious transaction,
- To ascertain the identity of the nominal and beneficial owners of, and the source of funds deposited into, each account as needed to guard against money laundering and report any suspicious transactions,
- To ascertain for any foreign bank, the shares of which are not publicly traded, the identity of the owners of the foreign bank, and the nature and extent of the ownership interest of each such owner, and
- To ascertain whether any foreign bank provides correspondent accounts to other foreign banks and, if so, the identity of those foreign banks and related due diligence information.

Under the USA PATRIOT Act, financial institutions are required to establish and maintain anti-money laundering programs which include:

- The establishment of a customer identification program,
- The development of internal policies, procedures, and controls,
- The designation of a compliance officer,
- An ongoing employee training program, and
- An independent audit function to test the programs.

The Bank has implemented comprehensive policies and procedures to address the requirements of the USA PATRIOT Act.

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

- Initial notices to customers about their privacy policies, describing the conditions under which they may disclose nonpublic personal information to nonaffiliated third parties and affiliates;
- Annual notices of their privacy policies to current customers; and
- A reasonable method for customers to "opt out" of disclosures to nonaffiliated third parties.

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

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

The Corporation entered into a Securities Purchase Agreement (the Agreement) on December 23, 2008 with the U.S. Treasury in association with its participation in the Capital Purchase Program (CPP) of the Emergency Economic Stabilization Act of 2008 (EESA). As a result of the Corporation's participation in the CPP, the Corporation may not pay a dividend in excess of $0.32 per share until the earlier of December 23, 2011 or the date the preferred shares have been redeemed in whole or transferred to a non-affiliated party.

Transactions with Affiliates. The Bank is subject to certain restrictions imposed by federal law on any extensions of credit to, or the issuance of a guarantee or letter of credit on behalf of, any affiliates, the purchase of, or investments in, stock or other securities thereof, the taking of such securities as collateral for loans, and the purchase of assets of any affiliates. Such restrictions prevent any affiliates from borrowing from the Bank unless the loans are secured by marketable obligations of designated amounts. Further, such secured loans and investments by the Bank to or in any affiliate are limited, individually, to 10% of the Bank's capital and surplus (as defined by federal regulations), and such secured loans and investments are limited, in the aggregate, to 20% of the Bank's capital and surplus. Some of the entities included in the definition of an affiliate are parent companies, sister banks, sponsored and advised companies, investment companies whereby the Bank or its affiliate serves as investment advisor, and financial subsidiaries of the bank. Additional restrictions on transactions with affiliates may be imposed on the Bank under the prompt corrective action provisions of federal law. See "Prompt Corrective Action and Other Enforcement Mechanisms."

Loans to One Borrower Limitations. With certain limited exceptions, the maximum amount that a national bank may lend to any borrower (including certain related entities of the borrower) at one time may not exceed 15% of the unimpaired capital and surplus of the institution, plus an additional 10% of unimpaired capital and surplus for loans fully secured by readily marketable collateral. At December 31, 2009, the Bank's loans-to-one-borrower limit was $5.6 million based upon the 15% of unimpaired capital and surplus measurement. At December 31, 2009, the Bank's largest single lending relationship had an outstanding balance of $7.0 million. Credit granted to this borrower in excess of the legal lending limit is part of the Legal Lending Limit Pilot Program approved by the OCC which allows the Bank to exceed its legal lending limit within certain parameters. The Bank's next largest single lending relationship had an outstanding balance of $4.3 million at December 31, 2009.

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

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

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

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In addition, federal banking regulators may set capital requirements higher than the minimums described above for financial institutions whose circumstances warrant it. For example, a financial institution experiencing or anticipating significant growth may be expected to maintain capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets.

Prompt Corrective Action and Other Enforcement Mechanisms. Federal banking agencies possess broad powers to take corrective and other supervisory action to resolve the problems of insured depository institutions, including but not limited to those institutions that fall below one or more prescribed minimum capital ratios. Each federal banking agency has promulgated regulations defining the following five categories in which an insured depository institution will be placed, based on its capital ratios: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. At December 31, 2009, the Bank exceeded the required ratios for classification as “well capitalized.”

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

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

Safety and Soundness Standards. The federal banking agencies have adopted guidelines designed to assist the federal banking agencies in identifying and addressing potential safety and soundness concerns before capital becomes impaired. The guidelines set forth operational and managerial standards relating to: (i) internal controls, information systems and internal audit systems, (ii) loan documentation, (iii) credit underwriting, (iv) asset growth, (v) earnings, and (vi) compensation, fees and benefits. In addition, the federal banking agencies have also adopted safety and soundness guidelines with respect to asset quality and earnings standards. These guidelines provide six standards for establishing and maintaining a system to identify problem assets and prevent those assets from deteriorating. Under these standards, an insured depository institution should: (i) conduct periodic asset quality reviews to identify problem assets, (ii) estimate the inherent losses in problem assets and establish reserves that are sufficient to absorb estimated losses, (iii) compare problem asset totals to capital, (iv) take appropriate corrective action to resolve problem assets, (v) consider the size and potential risks of material asset concentrations, and (vi) provide periodic asset quality reports with adequate information for management and the board of directors to assess the level of asset risk. These guidelines also set forth standards for evaluating and monitoring earnings and for ensuring that earnings are sufficient for the maintenance of adequate capital and reserves.

Insurance of Accounts. The deposits of the Bank are insured to the maximum extent permitted by the DIF. The FDIC administers the DIF, which generally insures commercial bank, savings association and state savings bank deposits. The DIF was created as a result of the merger of the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF), pursuant to the Federal Deposit Insurance Reform Act of 2005 (Reform Act).

In October 2008, the maximum amount insured under FDIC deposit insurance was temporarily increased from $100,000 to $250,000 per insured depositor through December 31, 2009. In May 2009, the FDIC extended this increased insurance level of $250,000 per depositor through December 31, 2013. On January 1, 2014, the standard insurance amount will return to $100,000 per depositor for all account categories except IRAs and certain other retirement accounts.

In October 2008, the FDIC announced its Temporary Liquidity Guarantee Program (TLGP) which provides full coverage for noninterest-bearing transaction deposit accounts at FDIC-insured institutions that agree to participate in the program. The unlimited coverage applies to all personal and business checking deposit accounts that do not earn interest, low-interest NOW accounts (accounts that cannot earn more than 0.5% interest), Official Items and IOLTA accounts. A 10 basis point surcharge is added to a participating institution's current insurance assessment. The Bank elected to participate in the TLGP. This unlimited insurance coverage is temporary and was originally scheduled to expire on December 31, 2009; however, in August 2009, the FDIC extended the program through June 30, 2010. The deposit insurance surcharge was increased from 10 to 25 basis points for institutions electing to participate in the extension.

Under the Reform Act, the FDIC's deposit insurance premiums are assessed through a risk-based system under which all insured depository institutions are placed into one of four categories and assessed insurance premiums based upon their level of capital and risk profile. The FDIC is authorized to establish annual deposit insurance assessment rates for members of the DIF and to increase assessment rates if it determines such increases are appropriate to maintain reserves of the insurance fund. In addition, the FDIC is authorized to levy emergency special assessments on DIF members. The FDIC may terminate deposit insurance if it determines an institution has engaged in or is engaging in unsafe or unsound banking practices, is in an unsafe or unsound condition or has violated applicable laws, regulations or orders. No institution may pay a dividend if it is in default of the federal deposit insurance assessment.

In October 2008, the FDIC published a restoration plan designed to replenish the DIF over a period of five years and to increase the deposit insurance reserve ratio to the statutory minimum of 1.15% of insured deposits by December 31, 2013. In March 2009, the deposit insurance reserve ratio was 0.27%. In order to accomplish this, the FDIC changed both its risk-based assessment system and its base assessment rates. For the first quarter of 2009, the FDIC increased all FDIC deposit assessment rates by 7 basis points. These new rates ranged from 12 to 14 basis points for Risk Category I institutions to 50 basis points for Risk Category IV institutions. Beginning April 1, 2009, the base assessment rates range from 12 to 16 basis points for Risk Category I institutions to 77.5 basis points for Risk Category IV institutions. As of December 31, 2009, the Bank was classified as a Risk Category I institution and as such was assessed an FDIC deposit assessment rate of 13.79 basis points.

In May 2009, the FDIC adopted a final rule imposing a 5 basis point special assessment on each insured depository institution's assets minus Tier 1 capital as of June 30, 2009. The special assessment was collected on September 30, 2009 and totaled $178,000.

In November 2009, the FDIC adopted a final rule requiring insured institutions to prepay three years of estimated insurance assessments. This prepayment strengthened the cash position of the DIF immediately without impacting earnings to financial institutions. Payment of the prepaid assessment for the years endings December 31, 2010, 2011 and 2012 was collected on December 30, 2009 and totaled $2.1 million. This prepayment was based upon assumed increases in insured deposits of 5% annually through 2012 with a three basis point increase in the proposed assessment rate for the years ending December 31, 2011 and 2012.

The FDIC may further increase the assessment rate schedule in order to manage the DIF to prescribed target levels. An increase in the risk category for the Bank or in the assessment rates could have an adverse effect on the Bank's earnings.

In addition, all institutions with deposits insured by the FDIC are required to pay assessments to fund interest payments on bonds issued by the Financing Corporation (FICO), a mixed-ownership government corporation established to recapitalize a predecessor to the DIF. The current annualized assessment rate is 1.06 basis points of insured deposits, or approximately 0.265 basis points per quarter. These assessments will continue until the FICO bonds mature in 2019.

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

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

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

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

- Establish the definition of "Intermediate Small Bank" as an institution with total assets of $250 million to $1 billion, without regard to any holding company; and
- Take into account abusive lending practices by a bank or its affiliates in determining a bank's CRA rating.

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

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

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

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

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

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

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

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

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

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

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

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

Federal Home Loan Bank System. The Bank is a member of the FHLB. Among other benefits, each FHLB serves as a reserve or central bank for its members within its assigned region. Each FHLB is financed primarily from the sale of consolidated obligations of the FHLB system. Each FHLB makes available loans or advances to its members in compliance with the policies and procedures established by the Board of Directors of the individual FHLB. As an FHLB member, the Bank is required to own a certain amount of capital stock in the FHLB. At December 31, 2009, the Bank was in compliance with the stock requirements.

Federal Reserve System. The FRB requires all depository institutions to maintain noninterest bearing reserves at specified levels against their transaction accounts (primarily checking) and non-personal time deposits. At December 31, 2009, the Bank was in compliance with these requirements.

Item 1A. Risk Factors

Deterioration of economic conditions in our geographic market area could hurt our business.

We are located in western Pennsylvania and our loans are concentrated in Butler, Clarion, Crawford, Jefferson and Venango Counties, Pennsylvania. Although we have diversified our loan portfolio into other Pennsylvania counties, and to a very limited extent, into other states, the vast majority of our loans remain concentrated in the three primary counties. As a result of this geographic concentration, our financial results depend largely upon economic and real estate market conditions in these areas. Deterioration in economic or real estate market conditions in our primary market areas could have a material adverse impact on the quality of our loan portfolio, the demand for our products and services, and our financial condition and results of operations. Non-performing assets increased from $1.1 million or 0.28% of total assets at December 31, 2008 to $2.6 million or 0.56% of total assets at December 31, 2009.

Our financial condition and results of operations would be adversely affected if our allowance for loan losses is not sufficient to absorb actual losses or if we are required to increase our allowance for loan losses.

We have established an allowance for loan losses that we believe is adequate to offset probable losses on our existing loans. However, experience in the banking industry indicates that a portion of our loans will become delinquent, that some of our loans may only be partially repaid or may never be repaid and we may experience other losses for reasons beyond our control. Despite our underwriting criteria and historical experience, we may be particularly susceptible to losses due to: (1) the geographic concentration of our loans; (2) the concentration of higher risk loans, such as commercial real estate and commercial business loans; and (3) our lack of experience with the loans acquired in the Titusville branch acquisition. As a result, we may not be able to maintain our current levels of nonperforming assets and charge-offs. Although we believe that our allowance for loan losses is maintained at a level adequate to absorb any inherent losses in our loan portfolio, these estimates of loan losses are necessarily subjective and their accuracy depends on the outcome of future events. If we need to make significant and unanticipated increases in our loss allowance in the future, our results of operations and financial condition would be materially adversely affected at that time.

Economic conditions and increased uncertainty in the financial markets could adversely affect our ability to accurately assess the allowance for credit losses. Our ability to assess the creditworthiness of our customers or to estimate the values of our assets and collateral for loans will be reduced if the models and approaches we use become less predictive of future behaviors, valuations, assumptions or estimates. We estimate losses inherent in our loan portfolio, the adequacy of our allowance for loan losses and the values of certain assets by using estimates based on difficult, subjective, and complex judgments, including estimates as to the effects of economic conditions and how these economic conditions might affect the ability of our borrowers to repay their loans or the value of assets.

Further declines in the value of certain investment securities could require write-downs, which would reduce our earnings.

At December 31, 2009, our investment portfolio included $2.8 million of securities in other financial institutions held by us. After our third quarter 2009 evaluation of our investment portfolio, we determined that other-than-temporary impairments existed on three financial institution equity securities. The impairment of these securities were considered to be other-than-temporary due to continued concerns related to the financial condition and near-term prospects of the three financial institutions, economic conditions of the financial services industry and deteriorating market values. These securities were written down to their fair market values as of September 30, 2009 and resulted in impairment losses of $898,000 that we recognized for the year ended December 31, 2009. A number of factors or combinations of factors could cause us to conclude in one or more future reporting periods that an unrealized loss that exists with respect to one or more of these securities or other financial institution securities will constitute an impairment that is other-than temporary. These factors include, but are not limited to, failure to make scheduled interest or dividend payments, an increase in the severity of the unrealized loss on a particular security, an increase in the continuous duration of the unrealized loss without an improvement in value or changes in market conditions and/or industry or issuer specific factors that would render us unable to forecast a full recovery in value. Additional other-than-temporary impairment write-downs could reduce our earnings.

We hold certain intangible assets that could be classified as impaired in the future. If these assets are considered to be either partially or fully impaired in the future, our earnings and the book values of these assets would decrease.

We are required to test our goodwill and core deposit intangible assets for impairment on a periodic basis. The impairment testing process considers a variety of factors, including the current market price of our common shares, the estimated net present value of our assets and liabilities and information concerning the terminal valuation of similarly situated insured depository institutions. It is possible that future impairment testing could result in a partial or full impairment of the value of our goodwill or core deposit intangible assets, or both. If an impairment determination is made in a future reporting period, our earnings and the book value of these intangible assets will be reduced by the amount of the impairment.

Liquidity risk could impair our ability to fund operations and jeopardize our financial condition.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, and other sources, could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities on terms that are acceptable to us could be impaired by factors that affect us specifically or the financial services industry or economy in general. Factors that could negatively impact our access to liquidity sources include a decrease in the level of our business activity as a result of a downturn in the markets in which our loans are concentrated, adverse regulatory action against us, or our inability to attract and retain deposits. Our ability to borrow could be impaired by factors that are not specific to us, such a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry in light of recent turmoil faced by banking organizations and the unstable credit markets.

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Our continued growth depends on our ability to meet minimum regulatory capital levels. Growth and shareholder returns may be adversely affected if sources of capital are not available to help us meet them.

As we grow, we will have to maintain our regulatory capital levels at or above the required minimum levels. If earnings do not meet our current estimates, if we incur unanticipated losses or expenses, or if we grow faster than expected, we may need to obtain additional capital sooner than expected, through borrowing, additional issuances of debt or equity securities, or otherwise. If we do not have continued access to sufficient capital, we may be required to reduce our level of assets or reduce our rate of growth in order to maintain regulatory compliance. Under those circumstances net income and the rate of growth of net income may be adversely affected. Additional issuances of equity securities could have a dilutive effect on existing shareholders.

There can be no assurance that recent legislation and regulatory actions taken by the federal government will help stabilize the financial system in the United States.

Several pieces of federal legislation have been enacted, and the U.S. Treasury, the FRB, the FDIC, and other federal agencies have enacted numerous programs, policies and regulations to address the current liquidity and credit crises. These measures include the EESA, the American Reinvestment and Recovery Act of 2009 (ARRA), and the numerous programs, including the CPP and expanded deposit insurance coverage, enacted thereunder. In addition, the Secretary of the U.S. Treasury has proposed fundamental changes to the regulation of financial institutions, markets and products.

We cannot predict the actual effects of EESA, the ARRA, the proposed regulatory reform measures and various governmental, regulatory, monetary and fiscal initiatives which have been and may be enacted on the financial markets, on us and the Bank. The terms and costs of these activities, or the failure of these actions to help stabilize the financial markets, asset prices, market liquidity and a continuation or worsening of current financial market and economic conditions could materially and adversely affect our business, financial condition, results of operations, and the trading prices of our securities.

We expect to face increased regulation of our industry, including as a result of EESA, the ARRA and related initiatives by the federal government. Compliance with such regulations may increase our costs and limit our ability to pursue business opportunities.

We are subject to additional uncertainties, and potential additional regulatory or compliance burdens, as a result of our participation in the CPP.

We accepted an investment of $7.5 million from the U.S. Treasury under the CPP. The Agreement we (and all other participating institutions) entered into with the U.S. Treasury, provides that the U.S. Treasury may unilaterally amend the agreement to the extent required to comply with any changes after the execution in applicable federal statutes. As a result of this provision, the U.S. Treasury and Congress may impose additional requirements or restrictions on us and the Bank in respect of reporting, compliance, corporate governance, executive or employee compensation, dividend payments, stock repurchases, lending or other business practices, capital requirements or other matters. We may be required to expend additional resources in order to comply with these requirements. Such additional requirements could impair our ability to compete with institutions that are not subject to the restrictions because they did not accept an investment from the U.S. Treasury. To the extent that additional restrictions or limitations on employee compensation are imposed, such as those contained in ARRA and the regulations issued in June 2009, we may be less competitive in attracting and retaining successful incentive compensation based lenders and customer relations personnel, or senior executive officers.

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Additionally, the ability of Congress to utilize the amendment provisions to effect political or public relations goals could result in our being subjected to additional burdens as a result of public perceptions of issues relating to the largest banks, and which are not applicable to community oriented institutions such as us. We may be disadvantaged as a result of these uncertainties.

As a result of the issuance of the Series A Preferred Stock to the U.S. Treasury, we are required to comply with certain restrictions on executive and employee compensation included in the EESA, as amended. Certain of these provisions could limit the amount and the tax deductibility of compensation we pay to our executive officers, and could have an adverse affect on our ability to compete for and retain employees and senior executive officers.

Higher FDIC deposit insurance premiums and assessments could adversely affect our financial condition.

FDIC insurance premiums have increased substantially in 2009 already, and we expect to pay significantly higher FDIC premiums in the future. A large number of bank failures has significantly depleted the deposit insurance fund and reduced the ratio of reserves to insured deposits. The FDIC adopted a revised risk-based deposit insurance assessment schedule on February 27, 2009, which raised deposit insurance premiums. On May 22, 2009, the FDIC also implemented a five basis point special assessment of each insured depository institution's assets minus Tier 1 capital as of June 30, 2009, but no more than 10 basis points times the institution's assessment base for the second quarter of 2009, which was collected on September 30, 2009. Additional special assessments may be imposed by the FDIC in the future, including a possible additional assessment in 2009. We participate in the FDIC's TLGP for noninterest-bearing transaction deposit accounts. Banks that participate in the TLGP pays the FDIC an annual assessment of 10 basis points on the amounts in such accounts above the amounts covered by FDIC deposit insurance. To the extent that these TLGP assessments are insufficient to cover any loss or expenses arising from the TLGP program, the FDIC is authorized to impose an emergency special assessment on all FDIC-insured depository institutions. The FDIC has authority to impose charges for the TLGP program upon depository institution holding companies, as well. The TLGP was originally scheduled to end December 31, 2009, but in August 2009, the FDIC has extended the TLGP to June 30, 2010, but is charging a higher fee to banks that elect to participate in the extension. These changes will cause our deposit insurance expense to increase. These actions could significantly increase our noninterest expense for the foreseeable future.

In November 2009, the FDIC adopted a final rule to recapitalize the DIF by requiring insured institutions to prepay their insurance premiums for the quarter ending December 31, 2009 and for the years ending December 31, 2010, 2011 and 2012. The prepayment was collected on December 30, 2009 and totaled $2.1 million. The FDIC further proposed that assessments for the years ending December 31, 2011 and 2012 would increase by three basis points, and would be based upon assumed increases in insured deposits of 5% annually through 2012. An increase in assessment rates will result in a further increase in our FDIC general insurance premium expense, and the prepayment of insurance premiums increased our non-earning assets.

Changes in interest rates and other factors beyond our control could have an adverse impact on our financial performance and results.

By nature, all financial institutions are impacted by changing interest rates. Among other issues, changes in interest rates may affect the following:

- the demand for new loans;
- the value of our interest-earning assets;
- prepayment speeds experienced on various asset classes, particularly residential mortgage loans;
- credit profiles of existing borrowers;
- rates received on loans and securities;

- our ability to obtain and retain deposits in connection with other available investment alternatives; and
- rates paid on deposits and borrowings.

Significant fluctuations in interest rates may have an adverse effect upon our financial condition and results of operations. The rates that we earn on our assets and the rates that we pay on our liabilities are generally fixed for a contractual period of time. We, like many financial institutions, have liabilities that generally have shorter contractual maturities than our assets. This imbalance can create significant earnings volatility, because market interest rates change over time. In a period of rising interest rates, the interest income earned on our assets may not increase as rapidly as the interest paid on our liabilities. In a period of declining interest rates, the interest income earned on our assets may decrease more rapidly than the interest paid on our liabilities.

In addition, changes in interest rates can also affect the average life of our loans and mortgage-backed and related securities. A reduction in interest rates results in increased prepayments of loans and mortgage-backed and related securities, as borrowers refinance their debt in order to reduce their borrowing cost. This causes reinvestment risk. This means that we may not be able to reinvest prepayments at rates that are comparable to the rates we earned on the prepaid loans or securities.

There are increased risks involved with commercial real estate and commercial business and consumer lending activities.

Our lending activities include loans secured by commercial real estate. Commercial real estate lending generally is considered to involve a higher degree of risk than single-family residential lending due to a variety of factors, including generally larger loan balances and the dependency on successful operation of the project for repayment. Our lending activities also include commercial business loans to small to medium businesses, which generally are secured by various equipment, machinery and other corporate assets, and a wide variety of consumer loans, including home equity and second mortgage loans, automobile loans and unsecured loans. Although commercial business loans and consumer loans generally have shorter terms and higher interest rates than mortgage loans, they generally involve more risk than mortgage loans because of the nature of, or in certain cases the absence of, the collateral which secures such loans.

In addition, we have a concentration of higher balance commercial real estate and commercial business loans with a limited number of borrowers in our market area. As a result, we have a greater risk of a significant loss due to such concentration and a greater risk of loan defaults in the event of an economic downturn in our market area as adverse economic changes may have a negative effect on the ability of our borrowers to make timely repayment of their loans.

Strong competition within our market area may limit our growth and profitability.

Competition in the banking and financial services industry is intense. In our market area, we compete with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, and other financial intermediaries operating locally and elsewhere. Some of our competitors have greater name recognition and market presence that benefits them in attracting business and offer certain services that we do not provide. In addition, larger competitors may be able to price loans and deposits more aggressively than we do, which could affect our ability to grow and remain profitable on a long term basis. Our profitability depends upon our continued ability to successfully compete in our market area.

Government regulation will significantly affect the Bank's business, and may result in higher costs and lower shareholder returns.

The banking industry is heavily regulated. Banking regulations are primarily intended to protect the federal deposit insurance funds and depositors, not shareholders. We are subject to extensive regulation, supervision and examination by federal, state and local governmental authorities, including the Federal Reserve Board and the Office of the Comptroller of the Currency. The burden imposed by federal and state regulations puts banks at a competitive disadvantage compared to less regulated competitors such as finance companies, mortgage banking companies and leasing companies. Changes in the laws, regulations and regulatory practices affecting the banking industry may increase our costs of doing business or otherwise adversely affect us and create competitive advantages for others. Regulations affecting banks and financial services companies undergo continuous change, and we cannot predict the ultimate effect of these changes, which could have a material adverse effect on our profitability or financial condition. Federal economic and monetary policy may also affect our ability to attract deposits and other funding sources, make loans and investments, and achieve satisfactory interest spreads.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

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

The Corporation owns and leases numerous other premises for use in conducting business activities. The Corporation considers these facilities owned or occupied under lease to be adequate. For additional information regarding the Corporation’s properties, see “Notes to Consolidated Financial Statements” beginning on page F-7.

Item 3. Legal Proceedings

Neither the Bank nor the Corporation is involved in any material legal proceedings. The Bank, from time to time, is party to litigation that arises in the ordinary course of business, such as claims to enforce liens, claims involving the origination and servicing of loans, and other issues related to the business of the Bank. In the opinion of management, the resolution of any such issues would not have a material adverse impact on the financial position, results of operation, or liquidity of the Bank or the Corporation.

Item 4. (Removed and Reserved)

PART II

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

Market, Holder and Dividend Information

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

Boenning and Scattergood, Inc.	Janney Montgomery Scott LLC	Monroe Securities, Inc.
4 Tower Bridge, Suite 300	1801 Market Street	100 North Riverside Plaza
200 Bar Harbor Drive	Philadelphia, PA 19103-1675	Suite 1620
West Conshohocken, PA 19428	Telephone: (215) 665-6000	Chicago, IL 60606
Telephone: (800) 889-6440		Telephone: (312) 327-2530

The Corporation has traditionally paid regular quarterly cash dividends. Future dividends will be determined by the Board of Directors after giving consideration to the Corporation's financial condition, results of operations, tax status, industry standards, economic conditions, regulatory requirements and other factors. As a result of the Corporation's participation in the U.S. Treasury's CPP, the Corporation may not pay a dividend in excess of $0.32 per share until the earlier of December 23, 2011 or the date the preferred shares have been redeemed in whole or transferred to a non-affiliated third party. For additional information regarding the Corporation's participation in the CPP, see "Notes to Consolidated Financial Statements" beginning on page F-7.

The following table sets forth the high and low sale market prices of the Corporation's common stock as well as cash dividends paid for the quarterly periods presented:

	Market Price			Cash
	High	Low	Close	Dividend
2009:				
Fourth quarter	$ 17.10	$ 12.11	$ 13.85	$ 0.14
Third quarter	18.30	15.85	17.10	0.14
Second quarter	23.50	17.50	18.00	0.14
First quarter	23.50	18.00	21.50	0.32
2008:				
Fourth quarter	$ 24.50	$ 20.05	$ 23.50	$ 0.34
Third quarter	26.50	21.00	24.00	0.32
Second quarter	28.00	24.60	25.75	0.32
First quarter	28.35	24.55	26.50	0.32

As of December 31, 2009, there were approximately 720 stockholders of record and 1,431,404 shares of common stock entitled to vote, receive dividends and considered outstanding for financial reporting purposes. The number of stockholders of record does not include the number of persons or entities who hold their stock in nominee or "street" name.

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

Purchases of Equity Securities

The Corporation did not repurchase any of its equity securities in the year ended December 31, 2009.

Item 6. Selected Financial Data

Not required as the Corporation is a smaller reporting company.

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

The following discussion and analysis represents a review of the Corporation's consolidated financial condition and results of operations. This review should be read in conjunction with the consolidated financial statements beginning on page F-3.

Overview

The Corporation reported a decrease in net income of $891,000 or 36.7% for 2009 as consolidated net income before accumulated preferred stock dividends and discount accretion amounted to $1.5 million or $0.80 per common share for 2009, compared to net income of $2.4 million or $1.87 per common share for 2008. Net income was impacted by the following:

- Net interest income grew by $1.8 million or 16.7% in 2009. This increase was driven by loan growth through the fourth quarter 2008 acquisition of ECSLA which added $7.3 million to the Corporation's loan portfolio, the extension of three, one-year tax anticipation notes to local municipalities totaling $11.5 million during the first quarter of 2009, and the third quarter 2009 purchase of a branch banking office in Titusville, Pennsylvania from PNC/National City in which $32.6 million of loans were acquired.
- The provision for loan losses increased $867,000 as a result of continued loan growth and pressure on borrowers related to the prevailing poor national economic conditions.
- Impairment charges totaling $898,000 were recognized during the third quarter of 2009 related to three marketable equity securities. Offsetting these impairment charges, the Corporation realized gains on the sale of certain U.S. government agency and mortgage-backed securities totaling $864,000.
- Costs associated with the Titusville branch purchase totaled $592,000 and were recorded during the second and third quarters of 2009. These costs included legal, project management, data conversion and valuation services, printing and mailing costs of required disclosure material, customer check replacement and other conversion costs.
- Stock offering costs totaling $484,000 were recognized during the fourth quarter of 2009 as the Corporation withdrew its common stock offering. These costs were primarily professional fees incurred for legal and accounting services. Also contributing to stock offering costs were fees associated with printing and filing various documents and travel expenses.
- Regular quarterly FDIC insurance premiums increased $402,000 from 2008 to 2009. In addition, the Bank recorded a $178,000 one-time charge during the second quarter of 2009 related to a special assessment that was assessed on all FDIC insured depository institutions.
- The Corporation recorded extraordinary income in 2008 totaling $906,000 associated with the acquisition of ECSLA.
- The Corporation's total assets grew by $91.9 million during 2009, primarily related to the Titusville branch purchase.

Changes in Financial Condition

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Changes in Results of Operations

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

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

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

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

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

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

2009 Results Compared to 2008 Results

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Market Risk Management

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

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

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

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

Interest Rate Sensitivity Gap Analysis

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

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

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

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

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

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

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

Interest Rate Sensitivity Simulation Analysis

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

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

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

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

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

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

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

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

Impact of Inflation and Changing Prices

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

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

Capital Resources

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

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

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

Liquidity

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

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

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

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

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

Critical Accounting Policies

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

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

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

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

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

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

Item 8. Financial Statements and Supplementary Data

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

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

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

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

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

Item 9A(T). Controls and Procedures

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

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

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

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

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

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

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

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

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

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

Item 11. Executive Compensation

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

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

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

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

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

Item 14. Principal Accountant Fees and Services

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

PART IV

Item 15. Exhibits and Financial Statement Schedules

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

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

(3) Management Contracts or Compensatory Plans:

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

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

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

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

3.2 Bylaws of Emclaire Financial Corp. (2)

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

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

4.1 Form of certificate for Preferred Stock. (3)

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

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

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

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

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

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

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

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

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

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

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

SIGNATURES

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

EMCLAIRE FINANCIAL CORP.

Dated: March 22, 2010

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

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

By: /s/ William C. Marsh
William C. Marsh
Chairman of the Board
Chief Executive Officer
President
Director
(Principal Executive Officer)

Date: March 22, 2010

By: /s/ Amanda L. Engles
Amanda L. Engles
Treasurer
(Principal Accounting Officer)

Date: March 22, 2010

By: /s/ Ronald L. Ashbaugh
Ronald L. Ashbaugh
Director

Date: March 22, 2010

By: /s/ David L. Cox
David L. Cox
Director

Date: March 22, 2010

By: /s/ James M. Crooks
James M. Crooks
Director

Date: March 22, 2010

By: /s/ George W. Freeman
George W. Freeman
Director

Date: March 22, 2010

By: /s/ Mark A. Freemer
Mark A. Freemer
Director

Date: March 22, 2010

By: /s/ Robert L. Hunter
Robert L. Hunter
Director

Date: March 22, 2010

By: /s/ John B. Mason
John B. Mason
Director

Date: March 22, 2010

By: /s/ Brian C. McCarrier
Brian C. McCarrier
Director

Date: March 22, 2010

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Report of Independent Registered Public Accounting Firm

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

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

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

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

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

Consolidated Balance Sheets

(Dollar amounts in thousands, except share data)

	December 31,
2009	